THE COMPARATIVE PERFOMANCE OF SELECTED AGRIBUSINESS COMPANIES AND COOPERATIVES IN THE WESTERN CAPE, SOUTH AFRICA.

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DECLARATION

By submitting this thesis electronically, I declare that the entirety of the work contained therein is my own, original work, that I am the authorship owner thereof (unless to the extent explicitly otherwise stated) and that I have not previously in its entirety or in part submitted it for obtaining any qualification.

Wellington Sikuka
March 2010

ABSTRACT

The main objective of the research is to understand the concept of cooperative conversions and compare the performance of converted cooperatives to those that never converted using financial accounting analysis and organisational dynamism. Even though the differences were relatively small, companies had the strongest relative financial performance than cooperatives. Companies had the strongest performances in asset and revenue growth. Average revenue growth for companies from 2004 to 2007 was 29% as compared to 15% by cooperatives and asset growth was 25% for companies compared to 12.5% by cooperatives. Results further indicate that for the past two years, cooperatives seem to be reporting decreasing performance in most of the financial ratios analysed. Thus, based on results from the financial analysis, operating as a company or converting from a cooperative to a company could result in slight increases in financial performance.

Rapid change presents various challenges and opportunities for businesses in today's dynamic environment. As a result, business dynamism is becoming an increasingly important aspect and factor in determining success. Based on a dynamism score card, the study shows that companies are by far much more dynamic than cooperatives, with a score of 83.75 compared to 62.33 out of 100 respectively. However, cooperatives compare relatively well to companies in as far as organisational strategy, management, organisational structure and culture. Their limitations come from their property rights framework which is by far less dynamic than that of companies owing to the limitations and constraints of the Cooperatives Act (Act 14 of 2005). The main shortcomings of cooperative property rights were that of not allowing external investors into the cooperative and the one member one vote principle for primary cooperatives or the 15% cap for secondary cooperatives.

OPSOMMING

Die vernaamste doelwit van hierdie navorsing was om die konsep van koöperatiewe omsettings te verstaan en die prestasie van omsette koöperasies te vergelyk met dié wat nog nooit deur middel van finansiële rekeningkundige analise en organisatoriese dinamisme omgesit is nie. Hoewel die verskille relatief klein was, het maatskappye die sterkste relatiewe finansiële prestasie gehad in vergelyking met koöperasies. Maatskappye het ook die sterkste prestasie in bate- en inkomstegroei getoon. Gemiddelde inkomstegroei vir maatskappye vanaf 2004 tot 2007 was 29%, in vergelyking met 15% vir koöperasies, terwyl bategroei vir maatskappye 25% was in vergelyking met 12.5% vir koöperasies. Die resultate toon verder dat koöperasies oor die afgelope twee jaar verminderde prestasie blyk te rapporteer in die meerderheid van die finansiële verhoudings wat geanaliseer is. Dus, op grond van die resultate van die finansiële analise, sal funksionering as ’n maatskappy of omsetting van ’n koöperasie na ’n maatskappy kan lei tot ’n effense verhoging in finansiële prestasie.

Snelle verandering bied verskeie uitdagings en geleenthede vir maatskappye in die huidige dinamiese omgewing. Gevolglik is sakedinamisme besig om ’n toenemend belangrike aspek en faktor in die bepaling van sukses te word. Op die basis van ’n dinamisme-telkaart het hierdie studie getoon dat maatskappye baie meer dinamies is as koöperasies, met ‘n telling van 83.75 in vergelyking met 62.33 uit 100 onderskeidelik. Koöperasies vergelyk egter relatief goed met maatskappye in soverre dit organisatoriese strategie, bestuur, organisatoriese struktuur en kultuur behels. Hulle beperkings kom van hulle eiendomsregraamwerk, wat baie minder dinamies is as dié van maatskappye op grond van die beperkings van die Wet op Koöperasies (Wet 14 van 2005). Die vernaamste tekorte van koöperatiewe eiendomsregte is dat hulle nie eksterne beleggers in die koöperasie toelaat nie en die beginsel van een lid, een stem vir primêre koöperasies of die 15% perk op sekondêre koöperasies.

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ABBREVIATIONS

ABC	Agribusiness Chamber
ANC	African National Congress
BEE	Black Economic Empowerment
CIPRO	Companies and Intellectual Property Registration Office
Comp A	Company A
Comp B	Company B
Comp C	Company C
Comp D	Company D
Coop A	Cooperative A
Coop B	Cooperative A
Coop C	Cooperative A
DTI	Department of Trade and Industry
EIA	Environmental Impact Assessment
EVA	Economic Value Added
FAO	Food and Agricultural Organisation
IOFs	Investor Oriented Firms
ICA	International Cooperative Alliance
ISCs	Investor-share Co-operatives
MICs	Member-investor Co-operatives
NGCs	New Generation Co-operatives
NIE	New Institutional Economics
NZDB	New Zealand Dairy Board
NOPAT	Net operating profit after tax
PICs	Proportional Investment Co-operatives
PWC	Price Water and Coopers
PPAA	Petroleum Products Amendment Act
P/E	Price to earnings ratio
R.O.A	Return on assets
R.O.E	Return on equity
USA	United States of America

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CHAPTER ONE
INTRODUCTION

1.1 Introduction

According to the Registrar General of Cooperatives in South Africa, about 90% of commercial cooperatives have converted to companies since 1993. Changing from a cooperative which by its nature is user (service) oriented, to a company which is investor (profit) oriented comes with significant changes to the (i) objectives, structure or purpose of the organisation, (ii) management and governance issues mainly ownership, control, management, organisational culture and styles (iii) performance measurement and expectations for example, shares (value, how they are managed and shareholding), profits (value and how they are distributed). Because of the significance of these changes, the decision to convert from a cooperative to a company needs to be well informed. The key question that serves as the main objective of the study is whether the conversion to the company business model enhances the performance of converted cooperatives relative to cooperatives that never converted.

Chaddad and Cook (2004) have attributed such organisational changes to the inherent weaknesses of the traditional cooperative business model mainly its ill defined property rights which result in the free rider, horizon, portfolio, control and influence costs problem. Chaddad and Cook (2004) further argue that such weaknesses or ill defined property rights of cooperatives have led to the emergence of new cooperative models (where policies have allowed such actions) such as the Proportional Investment Co-operatives (PICs), Member-investor Co-operatives (MICs), New Generation Co-operatives (NGCs), Cooperatives with capital seeking entities and Investor-share Co-operatives (ISCs) or alternatively outright conversions to companies. The study will use the property rights approach as the theoretical framework to understand the motives that induce such organisational changes and whether companies are a superior business form than cooperatives. In addition, central issues that have to be addressed before or during a conversion are those of changes in ownership and control, which can appropriately be analysed under the property rights framework.

Even though the research relies and acknowledges the relevance and importance of property rights in explaining organisational changes and performance, other factors apart from property rights that determine the success of business organisations in today's increasingly competitive and dynamic environment, mainly organisational dynamisms and culture, management styles, competence and incentives are investigated (Godo (2006); O'Connor (2001); Ruben & Lerman (2004)). The study seeks to further investigate and compare how cooperatives and companies are different in terms of these factors. In South Africa, the deregulation of markets and withdrawal of state support also resulted in fundamental changes to agribusinesses and the agriculture sector. Before 1996, most commercial cooperatives were heavily supported and even operated monopolies in certain industries. After, deregulation, cooperatives were forced to adapt or fail. Thus, in comparing dynamism, prudence will be observed as some of the changes were a result of cooperatives catching up to dynamic practices already implemented by companies.

By studying the conversions from cooperatives to companies, and researching whether the performance of cooperatives is enhanced if they convert, the research seeks to determine whether cooperatives are a superior or inferior business model in this regard. The answer to this question would be important in concluding whether the cooperative form of business still has merits in modern day business or is obsolete? Thus whether such conversion trends have to be accelerated or retarded in today's modern business environment. Of interesting note is the passing of the Cooperatives Act 2005 (Act 14 of 2005), which the study will also discuss in light of whether it accelerates or retards such conversions. Criticisms, merits or the way forward on such policies can only be levelled if clear understanding of the process and consequences of conversions are highlighted.

1.2 Research questions and issues

1.2.1 Questioning the relevance of cooperatives

Changes such as increased competition, changing policies, changing consumer profiles, interests or tastes are becoming too evident (Kyriakopoulos *et al*, 2004). As such, business organizations are forced to adopt their organizational structures and strategies to match such changes (Cook and Chaddad (2000); Evans and Meade (2005); Heit (2007); Kyriakopoulos *et al* (2004); O'Connor (2001) and Sykuta and Cook (2001)). An increasing trend of structural changes and strategies such as consolidations, mergers, acquisitions, strategic alliances, joint ventures and organisational changes such as strategic diversification, vertical integration, horizontal integration and conversions have also been reported in South Africa (Competition Commission, 2006). Chaddad and Cook (2004) show various types of cooperative models that have emerged mainly in developed countries such as the USA, New Zealand, Canada and the Netherlands where policies have permitted such actions. The move towards more investor oriented models such as outright conversions to companies' raises questions on the merits and demerits of the cooperative model compared to the investor oriented models. More interestingly is whether the cooperative business model has merits in modern day business or has become obsolete?

According to Chaddad and Cook (2004), cooperatives and companies can best be viewed as two polar forms of business models. As a result, various questions arise as to why a business changes to another polar business model and how such a change affects the organisation and stakeholders involved. There are various reasons and motives for converting from a cooperative to a company. Various motivations and theories have been proposed to explain why cooperatives convert (see section 5.6). Cook (1995) attributes the ill defined property rights of traditional cooperatives as the main cause of conversions of cooperatives to other organisational models such as the NGCs or investor oriented firms. However, other reasons such as political factors, changes in the institutional arrangements and policies or other individual (either is rational or irrational to pursue personal benefits) also motivate such changes (Collins (1991); Jorgensen (2001) and Merlo (2001)). Thus empirical evidence is needed to ascertain why cooperatives convert and whether these conversions are an inevitable evolutionary process, or instigated by other motives? The decision to convert is made against other alternative actions such consolidations, mergers, acquisitions, strategic alliances, joint ventures and organisational changes such as strategic diversification, vertical integration and horizontal integration. Against an understanding of the motives and reasons to convert a clear understanding is required on why some of these choices were overlooked.

Changing from a cooperative to a company has many implications because by their very nature, cooperatives which appear user oriented seem like a totally different organisation from companies which are investor oriented (Standard Bank, 2006). Cooperatives have been known to mainly serve their members by providing a service. Thus their motivation is more closely tied to the financial health of the members as opposed to the profit motive of companies. Thus when cooperatives convert to companies, there are changes that members, management and the organisation have to face e.g. the members implications to the nature and extent of services from the re-structured organisation, issues pertaining to ownership (shares, dividends) and control. Questions on whether member ownership increases or decreases when cooperatives convert and also which of the two business model (company or cooperative) makes a better investment choice.

When cooperatives convert to companies, the changes in the objective of the organisation have direct implications on management. Firstly in terms of how management shifts from a mindset of protecting the interests of members to that of being market oriented and investor oriented. Conflict of interests is expected when management tries to reconcile the economic self interest of shareholders who were previously members versus the interest of external investors. Such a conflict also raises the dilemma of the developmental imperative versus the economic or commercial imperative? In a cooperative, performance is based on the member's benefits as shown by the price of products and services they receive from the cooperative. However, in companies, profit, return on investment, shareholders` value constitute the main performance measures. It is interesting to compare how modern commercial cooperatives compare to companies in such performance measures as well as the nature and extent of performance incentives especially ownership that they offer to management?

1.2.2 Summary of research questions

In summary the main objective and specific research question the study seeks to address is;

i. How has the conversion to companies affected performance? Do cooperatives that have adopted the company business model perform better than cooperatives that never converted?

Subsequently the study will also seek to address the following questions;

ii. What are some of the external and internal reasons and motives that prompted the conversion?
iii. Are cooperatives necessarily a less efficient organisational structure than the company business model?
iv. Which challenges and opportunities were encountered during the process?
v. What are the implications of such a change to members in as far as service obtained, shares, control, dividends and member's wealth is concerned?
vi. How does the management reconcile the economic self interest of members versus the investors, or the developmental imperative versus the economic viability of the organisation?
vii. What are the implications of such a change to investors in as far as shares, dividends and return to investments is concerned?
viii. How has the organisation adapted to the needs of an advancing industrial society, that is, which organisations are more dynamic?
ix. How do converted cooperatives differ to those that never converted in as far as organisation culture, management culture, style, competence and incentives?

1.3 Theoretical Framework

There are various schools of thought ranging from economics, sociology, political science to anthropology that seek to explain organisational behaviour or more commonly, collective action, group coordination or groups attempting to organise and create collective benefits (Coase (1937), Demsetz (1997), Fama (1980), Hart (1989), Knight (1957), Milgrom & Roberts (1990), Olson (1965), Putterman (1993), Williamson (1985)). The research applies the property rights approach which lies in the domain of the New Institutional Economics (NIE). The relevance of the NIE comes from the fact that it seeks to explain the basis of the firm, its structure and its significance for a modern economic system, which form part of the key questions the research seeks to address. The property rights theoretical framework will be used to understanding issues pertaining to ownership and control whereas the business management approach will be the basis to understanding management culture, styles, competence and incentives as well as organisational culture.

The property rights approach is mainly concerned with how the assignment of and costs of transferring property rights affects incentives and economic outcomes (Demsetz (1967); Demsetz (1983); Demsetz (1997); Harvey & Sykuta (2005)). Property rights being claim, control or ownership rights entitled to a member. Thus the central issue is mainly of ownership and control. Thus the organisational form is important in mitigating property rights issues, particularly the separation of residual claim rights, ownership and control rights in modern firms (Hendrikse & Veerman, 2001b). Thus it follows that organisational structures with well clearly defined property rights should perform better than organisational structures with ill defined property rights.

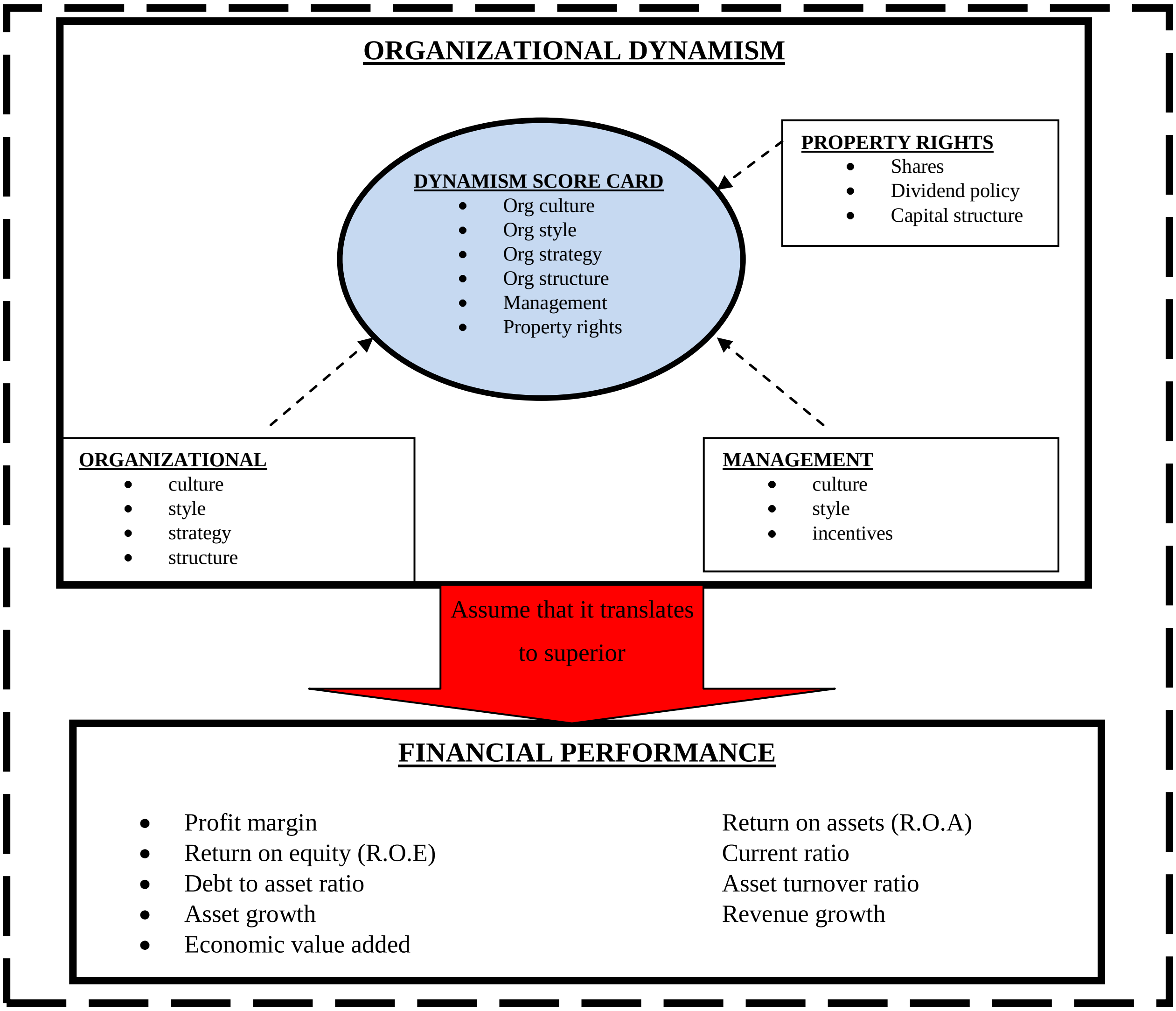
The property rights structure of the firm could be altered over time. Restructuring of property rights is usually done to improve incentives and/or lower transaction costs with a view to making the firm more efficient. Actions such as consolidations, mergers, acquisitions, strategic alliances, joint ventures and organisational changes such as strategic diversification, vertical integration, horizontal integration and conversions qualify as changes in property rights. However, sometimes such changes are not motivated or driven by pure efficiency considerations. For example, in the case of cooperatives, conversions can be driven by members or management with great bargaining power if it will be beneficial to them but detrimental to other members of the cooperative or the efficiency and performance of the cooperative.

In today's dynamic environment, it is argued that dynamic organisations are more successful than organisations that do not adapt to change quickly and comprehensively ((Ensley *et al* (2006); Priem *et al* (1995)). Dynamic organisations tend to be innovative and respond to market opportunities and challenges with speed and comprehensiveness. Dynamism is can be shown by organisational culture, style and strategy, management and the property rights of the organisation. A full discussion in chapter four on these issues enlightens why some business organisations are expected to be more successful than others.

1.4 Methodology

Comparing cooperatives to companies is complicated by their different intrinsic nature. Thus, to draw up objective and sound conclusions, a balanced comparative methodology adapted from the balanced score card is used. In today's dynamic business environment, there has been an increasing need for businesses to also track non financial measures in addition to the traditional financial ratios. Thus, in addition to financial accounting analysis, the study also uses a dynamism score card to investigate how cooperatives compare to companies in non financial business aspects such as management, property rights, organisational culture, style, strategy and structure. Figure 1 shows the different financial ratios that will be used to compare financial performance as well as the aspects that will be investigated to compare organisational dynamism. Primary data collected through semi structured interviews with the top management of the organisations will be used to investigate organisational dynamism. Financial statements of the cooperatives will be obtained from the Registrar of Cooperatives whereas those of companies will be acquired from published audited financial reports.

Figure 1: Analytical framework



1.5 Limitations of the study

There are several noteworthy limitations of the research. The generalizability of these research findings are limited because they are based on case studies which might not reflect or provide a conclusion for agribusiness in other regions or the whole country. More case studies need to be carried out to validate and compare the findings of this study. Secondly, because of data unavailability, the sample size is small resulting in various financial analysis limitations especially when averages are used for comparison. Finally, there are other critical factors that the study did not consider which could impact on the comparative performance of cooperatives to companies e.g. industry factors, political factors e.t.c.

1.6 Structure of the Study

The study is divided into eight chapters as discussed below;

- The first chapter introduces the research topic and articulates the research questions. A brief on the methodology and the motivation of the study are also explained.
- Chapter two will serve as an explanation of the methodology and analysis applied in the study as well as the data and background information on the agribusinesses analysed
- Chapter three is a background to cooperatives by discussing their evolution and various factors that have influenced their development. The chapter also includes a section on the changes and sometimes conflicting roles or imperatives of cooperatives in order to ascertain their role in today's modern economy.
- Chapter four discuses performance as well as organisation dynamism, organisation culture, management culture and style, management incentives, management competence or ability in respect of their influence on performance.
- Chapter five provides a review of the property rights approach which is the conceptual framework used to understand the conversions to companies. The Property rights approach will be applied to understand the formation and behaviour of cooperatives as compared to investor oriented business organisations.
- Chapter six presents the results from the questionnaire empirical analysis and comparative dynamism.
- Chapter seven presents the results from the financial analysis
- Chapter eight presents the summary of the results, conclusion and presents suggestions for future research.

CHAPTER TWO
RESEARCH DATA AND METHODOLOGY

2.1 Introduction

The objective in this chapter is to explain the data, methodology and analysis applied in the study. The first section outlines previous studies on cooperative performance and restructuring which gave an informed decision on the research methodology. These studies largely fall into two categories, i.e. (i) studies based on financial ratios and (ii) studies based on economic efficiency (Evans & Meade, 2005). The study will use financial accounting analysis, and a dynamism score card to indicate how cooperatives compare to companies in critical aspects such as management, property rights, organisational culture, style, strategy and structure. A description of the agribusiness selected for the study, questionnaire survey and financial accounting data will be provided. The chapter concludes with an overview of how each specific research question will be addressed.

2.2 Previous studies on cooperative performance and restructuring

Studies that have compared cooperatives to companies using financial ratios show mixed conclusions. Chan and Robb (1998), Lerman and Parliament (1990) and Parliament *et al* (1990) concluded that contrary to theoretical predictions cooperatives and companies were similarly leveraged and generated similar returns. In other cases, cooperatives financially outperformed comparable companies (this was especially true for dairy cooperatives because they are capital intensive and the farmer members involved were efficient). However, studies by Hardesty and Salgia (2004) and Schrader *et al* (1985) reveal no significant differences in financial performance but state that, large, diversified agribusiness companies had significantly higher returns on asset than cooperatives.

Porter and Scully (1987) examined the relative efficiency of cooperatives and companies according to eight different measures (such as price, scale, and technical efficiency). Porter and Scully (1987) indicate that cooperative milk processors were on average only 75.5% as efficient as their company counterparts, and that by reorganising as companies, cooperative milk processors could raise output by 32.4% without requiring extra inputs. Porter and Scully (1987) attributed this inefficiency to problems with cooperative property rights, specifically the horizon, control, free rider, and portfolio problems as summarised by Cook (1995). Boyle (2004) investigated the economic efficiency of Irish dairy cooperatives from 1961 to 1987 and reports that cooperatives price their inputs as if they were profit maximisers (similar to companies) and did not price inefficiently as expected.

Doucouliagos and Hone (2000) indicate that the Australian dairy industry was dominated by two large Victorian cooperatives (Murray Goulburn and Bonlac), accounting for half the market and that dairy deregulation had encouraged improved industry performance because there was convergence in productivity levels across agribusinesses and states. Sullivan and Scrimgeour (1995) compare the performance of the New Zealand Dairy Board (NZDB) to Nestle from 1969 to 1992 and concluded that Nestle appeared to be more efficient than the NZDB. This is in contrast to the dairy sector analyses of Lerman and Parliament (1990), and Parliament *et al* (1990).

Thus from the studies surveyed, overall there is no clear support for the theoretical prediction that cooperatives will be less efficient and/or less profitable than companies (Evans and Meade, 2005). In any case, Chaddad and Cook (2004) show that certain inefficiencies predicted to arise in traditional cooperatives are being resolved with tradable cooperative ownership rights based on fair values. Comparison of cooperatives to companies has also come with criticism. Babb and Boynton (1981) argue that cooperatives represent the vertical integration of the producers' firms, thus, it is inappropriate to evaluate performance of the joint entity by examining data for only a portion of the entity. For example, a cooperative could be less profitable than a company and still be desirable to a member as long as the member's discounted income returns from the cooperative were greater than those from marketing the commodity directly or through a company. Babb and Boynton (1981) also indicate that critical stakeholders associated with cooperatives are more concerned with financial ratios than they are about measures of economic efficiency. Thus to address any bias that can result from conclusions based on only financial accounting analysis, the study will do a balanced comparison of the financial performance and other qualitative factors such as organisational dynamism.

2.3. Research methods

2.3.1 Financial accounting analysis

Table 1 gives a description of how the financial ratios used in the study are calculated and interpreted. The industry benchmark based on the agribusiness benchmarking survey conducted in 2006 and 2007 by Price Water and Coopers and will be used to provide comparable data on the performance of both cooperatives and agribusiness relative to the industry performance. However, the study takes note that the benchmarks are purely averages and not the best performance levels.

Table 1: How financial ratios are calculated and interpreted in the study

Measure	Calculation	Interpretation
1. PROFITABILITY		
Profit Margin	Net farm Income plus interest minus family living and taxes divided by gross revenue	The proportion of earnings or revenues that is operating profit and thus available to compensate debt and equity capital. indicates the operating margins and reflects the ability to generate revenues and control costs in such a way as to generate a profit
Return On Assets (R.O.A)	The net income generated by all assets, after labour has been compensated but before interest payments, divided by total assets	A measurement of profitability that indicates the profitability per rand of assets, thus allowing comparisons over different size firms and different types of business/investment
Return on Equity (R.O.E)	The net income after all labour and interest charges, which is the residual return to the owners investment divided by the equity investment.	A measurement of the return the owner of the business receives on his/her money invested. Can be compared to rates of return in other investment opportunities such as stocks, bonds, or savings accounts. a rate of return on equity that is less than the rate of return on assets indicates unproductive use of borrowed funds
2. LIQUIDITY		
Current Ratio	Calculated as current assets (Inventories, cash, accounts receivables, e.t.c) divided by current liabilities (operating loan payments, accounts payable, unpaid taxes due, this year's payments on term loans, accrued interest and rent, etc.)	A basic indicator of short term debt servicing and/or cash flow capacity. It indicates the extent to which current assets, when liquidated, will cover current obligations. It does not predict the timing of cash flow during the year or the adequacy of future fund inflows in relation to outflows.
3. SOLVENCY		
Debt to Asset ratio	Total liability divided by total assets	The basic leverage of the business, (i.e. what proportion of the total farm assets is owed to creditors). Measures the ability of the business to repay all financial obligations if all assets were sold.
4. GROWTH		
Revenue growth	Calculated as the annual increases in the total value of products and services produced by the business on an accrual basis as reflected on principal the income statement.	Reflects the growth of the business more specifically the income from sales and other sources available annually to cover expenses, loan payments, family living, income taxes, expansion, etc.
Asset growth	Calculated as the annual increases in the total value of assets as reflected on the balance sheet	Reflects the growth of the business and its capital base from which income can be made from.
5. FINANCIAL EFFICIENCY		
Asset turnover ratio	Gross revenues divide by total assets	Reflects how efficiently farm assets generate revenues, indicates the volume of business generated by the asset base (i.e. the flow of revenue through the asset pipeline). Can show wide variation depending on the proportion of owned land or other assets
6. SHAREHOLDER VALUE		
Economic value added (EVA)	$\left\{\frac{\text{After tax operating income}}{\text{Capital Invested}} - \text{Cost of Capital}\right\} \times \text{Capital Invested}$	Economic value added is a value based financial performance measure, an investment decision tool and a performance measure reflecting the absolute amount of shareholder value created (Geyser & Liebenber, 2003)

Source: Boehlje *et al* (1999).

2.3.2 Economic value added

The key principle underlying EVA is that value is created when the return on an investment exceeds the total cost of capital that correctly reflects its investment risk. A positive EVA implies that the rate of return on capital must exceed the required rate of return (Hall & Geyser, 2004). Thus, EVA is the net operating profit minus an appropriate charge for the opportunity cost of all capital invested in an enterprise or project. EVA gives an objective comparison of shareholder value for both cooperatives and companies because it captures the following activities to create value that are common to cooperatives and companies (Hall & Geyser, 2004):

- Generate higher cash flows from existing assets, without affecting its growth prospects or its risk profile.
- Reinvest more and with higher excess returns, without increasing the riskiness of its assets.
- Reduce the cost of financing its assets in place or future growth, without lowering the returns made on these investments.

Geyser & Liebenberg (2003) state that when calculating EVA, the after-tax operating income has to be adjusted for operating leases, R&D expenses and one-time charges to compute the return on capital. At the minimum, three adjustments need to be made to capital invested when computing EVA — converting operating leases into debt, capitalizing R&D expenses and eliminating the effect of one-time or cosmetic charges (O'Byrne, 1996). The cost of capital should be estimated based upon the market value of debt and equity in the firm, rather than book values (Kramer & Pushner, 1997). Like other financial performance measures, EVA has its own limitations, chiefly;

- EVA on its own is inadequate for assessing a company's progress in achieving its strategic goals and in measuring performance.
- EVA will not work as a value enhancement measure unless there is a commitment on the part of managers to make value maximization their primary objective (Geyser & Liebenberg, 2003).

2.3.3 Questionnaire survey and the dynamism score card

The questionnaire survey is used to collect data for investigating dynamism and for the scores used in the dynamism score card. The study classified the questionnaire into six sections mainly; (i) organisational information and culture, (ii) organisation restructuring and dynamism (iii) performance information, (iv) ownership information (v) management culture, style, competence and incentives, and (vi) policies or legislation. The questionnaire survey will be carried out through semi structured interviews with top management of the agribusinesses. The respondents were part of the top management and thus the assumption is that they presented a fairly rational and valid sample for the study to analyse their organisation and management.

The study compares dynamism in cooperatives versus companies using a dynamism score card (Table 2) that ranges from 0 to 100, with 0 indicating a firm that is not dynamic at all and 100 indicating a highly dynamic company. The various agribusinesses were scored on four factors, which are, organisational strategy, organisational structure and culture, management and their property rights framework based on what theory and literature review suggested as dynamic practices. For example, firms with a BEE scoring of less than 40 points are given a dynamisms score of 1 whereas those with a BEE scoring of 41 to 65 were given a score of 2 and finally those with a BEE scoring of above 65 were given a dynamism score of 3. The four factors, organisational strategy, organisational structure and culture, management and their property rights framework were all given the same weightings of 25%. More research needs to be done to develop an objective dynamism score card that could be used for analysing the dynamism of agribusinesses (There is none to date).

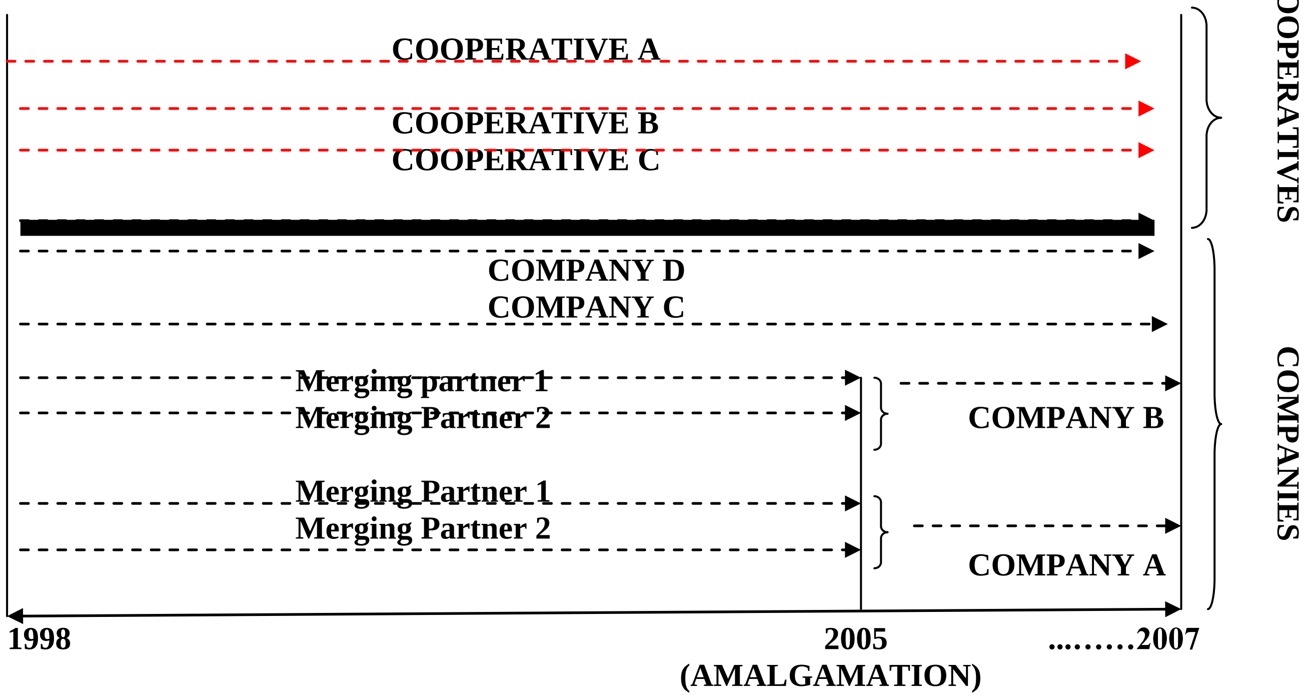
Table 2: Dynamism score card

Factor	Specific criteria of comparing dynamism	Score
1 Organisational strategy	Role in corporate social investment	3
	Environmental sustainability or eco sensitive initiatives	3
	Nature of investments	5
	BEE score card	3
	Accounting reporting method	3
	Changes in customers	4
	Changes in product mix or services and value addition	4
2 Management	Management style	10
	Management incentives and compensation	15
3 Organisational structure and culture	Organisational culture	10
	Structure of the organisation	5
	Restructuring actions in the past 5 years?	5
	Type of investors	5
4 Property rights framework	Shares (price, how they are redeemed, classes)	10
	Dividend policy	5
	Voting principle	5
	Capital structure	5
	TOTAL DYNAMISM SCORE	100

2.4 Description of agribusinesses and data

The study will use three cooperatives and four companies that were previously cooperatives. The cooperatives selected include the grain and oil seed cooperatives. However, because of diversification and ownership in other organisations, the agribusinesses are involved in various sectors such as grain, input supply and other downstream activities. For the sake of information privacy, the study will use the following names for the organisations, cooperative A, cooperative B, cooperative C, company A, company B, company C and company D. Company A was formed by a merger in 2005 involving two companies that were previously cooperatives but converted to companies in 1998. The same applies to Company B, whereas Company C has been a company since 1998 and Company D converted from a cooperative to a company in 1998. All the cooperatives have been in operation well before 1998 and are still registered as cooperatives. Figure 2 below shows the agribusinesses used for analysis and the duration of financial statements under review.

Figure 2: Agribusinesses and the financial years considered



Financial statements of the cooperatives will be obtained from the Registrar of Cooperatives, a subdivision of the Companies and Intellectual Property Registration Office (CIPRO). Whereas those of companies will be acquired from published audited annual financial reports.

2.5 Summary of the research questions and analysis

Main objective and specific research question

i. How has the conversion to companies affected performance? Do cooperatives that have adopted the company business model perform better than cooperatives that never converted?

Financial accounting analysis will be used to assess the relative performance of the agribusinesses. A wide range of financial performance measures (profitability, liquidity, solvency, financial efficiency and growth) will inform the conclusion on how agribusinesses performed from the year 1998 to 2007.

Subsequently the study will also seek to address the following research questions;

ii. Why have cooperatives converted? What are some of the external and internal reasons and motives that prompted conversion?

A questionnaire survey will be conducted to gain insight and acquire answers on the key reasons and motives. The property rights approach will form the basic literature to understand cooperative conversions.

iii. Are cooperatives necessarily a less efficient organisational structure than the company business model?

Financial efficiency ratios will be applied to investigate which agribusinesses where relatively more efficient or inefficient.

iv. Which challenges and opportunities were encountered during the process?

The questionnaire survey will be used to investigate company specific experiences with regard to the conversion process. The property rights approach will provide the literature review on some of the challenges and opportunities encountered during the conversion process, specifically ownership and control issues..

v. What are the implications of such a change to members in as far as services obtained, shares, control, dividends and member's wealth is concerned?

EVA will be used to objectively compare shareholders value. In addition, the questionnaire survey will be used to show how cooperatives and companies differ in as far as control and ownership issues are concerned.

vi. How does the management reconcile the economic self interest of members versus the investors, or the developmental imperative versus the economic viability of the organisation?

The property rights approach, specifically agency theory will inform the study on the issue of conflict of interest. However, the questionnaire interviews will prompt answers on how such conflicts of interests are addressed or handled if they do indeed exist.

vii. What are the implications of such a change to investors in as far as shares, dividends and return to investments is concerned?

The property rights approach will form the basic framework of analysis to understand the issue surrounding this question. However much of the answers will be obtained from the financial accounting analysis.

viii. How has the organisation adapted to the needs of an advancing industrial society?

The study will use the questionnaire to investigate dynamism and how the agribusinesses are adapting to the dynamic environment. A dynamism score card will be used to provide an objective comparison and score to compare how dynamic the organisations are. Management theory will provide the theoretical framework to understand organisational dynamism.

ix. How do converted cooperatives differ to those that never converted in as far as organisation culture, management culture, style, competence and incentives?

The study will use the questionnaire to investigate the different organisation cultures, management cultures, styles, competence and incentives. Management theory will provide the theoretical framework to understand the concept of organisational culture, management culture, style, competence and incentives.

CHAPTER THREE
UNDERSTANDING AGRICULTURAL COOPERATIVES

3.1. Introduction

The objective in this chapter is to give an insight of the role of institutions in organizational design (Institutions as defined as the rules of the game). It is important to discuss the historical development of agricultural co-operatives in South Africa in order to understand how and why cooperatives behave the way they do today. The chapter discuses the origin of cooperatives and the resulting impacts some policies had on their development in South Africa. For example, why there is a dominance of successful white commercial cooperatives as opposed to unsuccessful black cooperatives e.t.c. The chapter also discusses the cooperative thinking, nature and its essence. The core of the chapter is the discussion of the changes and sometimes conflicting imperatives of cooperatives. This discussion serves to inform on whether cooperatives do have a role or are obsolete in today's modern economy.

3.2 Origin and development of cooperatives

History has been shown to be of significant importance in the shaping of institutions and in explaining current institutional trends (Karaan (2004) and Van Niekerk (1998)). Cooperative arrangements and principles of cooperation have been shown to date back to the BC period (Van Niekerk, 1998). However, the popularity of the cooperative movement began with the application of cooperative principles to the business organization. Even though earlier unsuccessful attempts on cooperatives were made by individuals such as Owen, the Rochdale society of equitable pioneers formed in 1844 is widely acknowledged and publicised as the first successful cooperative (Birchal (2003); Ortmann & King (2007a); Ortmann & King (2007b) and Van Niekerk (1998)).

Van Niekerk (1998) states that the Rochdale society of equitable pioneers was formed by a group of 28 weavers and artisans in Rochdale, England. The underlying reason being to work together and take advantage of economies of scale by opening their own store selling food items that they could not otherwise afford individually. In order to avoid failure as was the case with other groups that attempted cooperative actions earlier, they designed the Rochdale principles which are still the underlying principles that today's cooperatives are based. The Rochdale principles are discussed below (ICA, 2008);

- **Open membership**; The years around the establishment of the Rochdale cooperative in 1844 coincided with poverty, misery, lack of schools and housing, economic individualism and the industrial revolution. Almost every other form of organisation at the time was created to discriminate to ensure that its benefits went to its members who were of the same class, gender, or religion. However, by having open membership the cooperative was designed to be accessible to the poor and thus serving as a developmental organisation.
- **Democratic control (one person, one vote)**; The one person, one vote element was a clear principle that the cooperative was committed to democracy which did not separate or give powers to different individuals based on their wealth or power. The co-operative also allowed for equality of opportunity for both men and women to own shares.
- **Distribution of surplus in proportion to trade**; Profits to the user owner set co-operatives apart from other firms which pay profits to the owners of capital. The emphasis on co-operatives was the patronage of its members as compared to their capital.
- **Payment of limited interest on capital**; The intent of the pioneers was to adequately reward capital but to use the majority of profits to reward usage. The other distinguishing element was that shares in the co-operative were maintained at par value to which interest would be paid, rather than the shares being decided in the market.
- **Political and religious neutrality**. This principle was added because of Owen, who held a wide range of views on societies which were very progressive at the time but a number of them were repugnant to many religious groups. As a result, the Rochdale co-operative adopted this principle to ensure that the society did not involve issues which had no relationship to the co-operative.
- **Cash trading (no credit extended)**. One of the major causes of failure in earlier attempts of cooperatives had been the extending of credit to members. Thus the co-operative felt strongly that it would serve its members better if it educated them to budget their wages and buy at the co-operative.
- **Promotion of education**; This principle appeared in 1854 after the Registrar allowed co-operatives to set aside money for education. Prior to that the co-operative had illegally set aside money for education. Initially the pioneers focused on educating

their members through providing courses, adult classes, lectures, newspapers and a library. Through their education programs, the pioneers were to give their members the tools to get better jobs and gain newer skills. Later, as public education filled their role, the co-ops concerned themselves much more with the role of cooperative education.

The success of the Rochdale cooperative resulted in a wave of cooperative formations around the world. Agriculture cooperatives were mainly more popular in the USA and Netherlands, from as early as around 1876 and 1877 respectively. In South Africa, cooperatives are reported to have been registered even before the union of the then four main provinces, Natal, Cape, Transvaal and Orange Free State which led to the formation of South Africa in 1910 (Van Niekerk,1998). The Pietermaritzburg consumer cooperative that was registered in 1892 in the Natal province in terms of the Companies Act is argued to be the first probable cooperative. According to Van Niekerk (1998) cooperatives were mainly involved in three main areas of business

- the purchase and sale of agricultural inputs and equipment
- the purchase, storage and subsequent sale of agricultural commodities
- transport services
- financial intermediaries to commercial farmers at subsidized interest rates

3.3 Policy, economic and regulation influences[1]

Prior to the union of South Africa, legislation that directly affected cooperatives such as the Company's Act (there was no Cooperatives Act until 1908) and the Natal Agricultural Development Act of 1904 had little impact on the positive development of cooperatives. The Companies Act is argued to have been unsuitable as cooperatives could not comply with its stringent legal provisions. On the other hand, even though the Natal Agricultural Development Act of 1904 was empowered to grant loans to cooperatives, its influence was limited because it was not adequately used or used at all. Even though there already were a few agricultural cooperatives when the Cape Development Act of 1905 was passed, it resulted in a large number of cooperatives being established in the Cape Province within a few years because it made available easy loans to agriculture cooperatives. However, a large number of these cooperatives failed.

[1] This section relies heavily on Van Niekerk (1998).

The Transvaal Land Bank Act of 1907 played a huge role in the development of cooperative legislation. The Transvaal Land Bank Act of 1907 led to the creation of the land bank for the Transvaal that granted loans to cooperatives and enabled cooperatives to regulate their financial affairs more easily. The Transvaal Land Bank Act of 1907 was passed as the Cooperatives Act of 1908 in 1908. This act contributed to the successful development of cooperatives in the Transvaal because of its two provisions that were included to avoid the shortcomings which emerged in other provinces. The two provisions were (i) unlimited liability of members jointly and severally, and (ii) a superintendent would be appointed to do regular inspection of cooperatives. However, the unlimited liability lost popularity because many members lost a significant amount of money when some of these cooperatives failed.

According to Van Niekerk (1998), after the union of South African states, the Land and Agricultural Bank of South Africa established in 1912 was fundamental in the development of cooperatives through the financing of cooperatives. The passing of the Land Bank Act of 1913 saw increased support to white commercial farmers and cooperatives through the provision of subsidized credit at rates of interest that were cheaper than those available from commercial banks. The Land Bank was prohibited from making such finance available to other business organisations (Van Niekerk, 1998).

From the union of South Africa in 1910 to the first Cooperative Society Act, Act 28 of 1922, several cooperatives were established but several others also disappeared. The shortage of inspectors and the distrust of farmers in the cooperative philosophy and its application was regarded as the key reasons for the failure of cooperatives. The first Cooperative Society Act, Act 28 of 1922 was the first legislation to control cooperatives in all provinces in South Africa. This gave the registrar the opportunity to treat all cooperatives in a uniform manner and steer them in the same direction.

The Cooperative Societies Act, Act 28 of 1922 was amended in 1925 when the Cooperatives Societies Amendment Act, Act 38 of 1925 was passed in order to strengthen the bargaining power of cooperatives and to give them full control over the products in the interest of all farmers. This act helped farmers to secure input supply and output marketing services. However, because of the world depression of 1929 to 1933, the South African economy and agriculture were affected negatively in terms of dropping prices. Cooperative members increased even though revenues decreased as they sought refuge in cooperatives. This lead to the birth and reinforcement of the attempts to extend the application of compulsory sale of produce by means of agriculture cooperatives. Thus the 1933 Commission of inquiry which contributed significantly to the passing of the Marketing Act 1937 and the Cooperative Society Act, Act 29 of 1939 was appointed to investigate the cooperatives and agricultural credit.

The Marketing Act 1937 presented a new era to agriculture and agriculture cooperatives that would later shape how cooperatives behave even today. The Marketing Act of 1937 introduced different types of marketing schemes for different agricultural commodities. The powers available under these schemes included monopoly buying, single channel exports, control over agro-processing and quantitative controls over imports etc. The Act appointed control boards as the sole marketing organisations which in turn favoured cooperatives against non-cooperative organisations to serve as agents for the control board. The economic reason behind such action was argued to be the depression that had caused low prices, which meant that farmers individual bargaining power was low, so control boards were seen as the only logical means by which agriculture producers could strengthen their bargaining power, reduce the gap between producer and consumer prices as well as obtain more satisfactory and stable prices for their products.

However, in employing control boards, the price forming functions of cooperatives were destroyed. The fixed prices as set by the control boards meant that all producers, members or non members received the same price for their products. Thus cooperatives strongest economic argument for their existences at the time, the bargaining for better prices, fell. Therefore the incentives to become cooperative members also disappeared. However, their existence did not disappear? The control boards employed agents to undertake the physical handling of products (collecting, grading storing and distribution) and in most cases cooperatives were employed as the agents. Hence, the result was that cooperatives enjoyed state support and thrived during this era with the majority of cooperatives becoming monopolies in different key agricultural sectors in the marketing of agriculture produce. However, perhaps because of the biased nature of the government and political economy at the time white commercial farmers tended to be primarily favoured to access such services, support and incentives than black farmers. Thus the cooperatives that thrived were commercial cooperatives that were predominantly white as opposed to the developing sector, which is predominantly black.

The Cooperative Societies Act, Act 28 of 1922 gave way to the Cooperative Society Act, Act 29 of 1939 in 1939. The Cooperative Society Act, Act 29 of 1939 included recommendations of the 1933 Commission of inquiry into cooperatives and agricultural credit. After 1939 to around 1960 the trend in cooperative development changed. Contrary to popular opinion that cooperatives should only serve a certain magisterial district and undertake a restricted series of functions, there was a noticeable trend in the direction of larger cooperatives expanding their branches and depots over large areas with a central head office. This was especially the case of most grain cooperatives in the Transvaal, Orange Free State and to a lesser extent in the Eastern, Southern and Western Cape. The principle of unlimited liability lost popularity and the number of cooperatives with unlimited liability reduced in numbers as most converted to limited liability.

In 1963 a Commission of inquiry was set up which led to the publication of the Steenkamp report in 1967 which was fundamental to the formulation of the Cooperative Act, Act 91 of 1981. The Cooperative Act, Act 91 of 1981 provided for the establishment, incorporation, functioning, winding up and dissolution of cooperatives, and the appointment of the Registrar of cooperatives. The Cooperative Act, Act 91 of 1981 incorporated some agreements that were reached between the government and the South African Agriculture Union in 1979 based on recommendations made by the Steenkamp Report in 1967.

The Marketing of Agricultural Products Act, No 47 of 1996 led to the deregulation of the agriculture sector accompanied by reduced state support and intervention (Groenewald, 2000) and Vink & Kirsten (2000)). Control boards and marketing schemes were disbanded. This resulted in a shift to a market economy that sought to allow free and fair participation by all the different stakeholders. As a result, organizations were exposed to increased competition from both local and international stakeholders (Doyer *et al* (2007); Groenewald (2000) and Vink & Kirsten, (2000)). The transition from a regulated era with massive state support to a much more competitive deregulated market economy era meant that cooperatives had to be competitive if they were to survive. Cooperatives no longer enjoyed the support and preferential treatment that they were accorded as agents for control boards and support from the land bank. Thus a number of cooperatives faced viability challenges or the pressure of competition (AGRITV (2003); Groenewald (2000); Kruger (2000); Ortmann & King (2007b); Ortmann (2005); Ortmann (2002)). Thus there was a noticeable trend in various restructuring actions such as consolidations, mergers, acquisitions, strategic alliances, joint ventures and organisational changes such as strategic diversification, vertical integration, horizontal integration and conversions with reported cases of a number of cooperatives closing down (Competition Commission, 2006).

History of the policies and legislation show that biased support was given to commercial agriculture cooperatives which were predominantly white as opposed to the developing cooperatives that are predominantly black. Thus the development of cooperatives in South Africa is best described by two parallel advancements, successful agricultural commercial cooperatives versus hugely unsuccessful cooperatives in the developing sector (Holloway *et al* (2000); Kirsten & Satorious (2002) and Van der Walt (2005)). However, this is not to say that there haven't been any cooperative failures in the commercial sector, cases of failure have been reported from as early as 1905 (Van Niekerk, 1998). In a recent study of a sample of 54 registered cooperatives in Limpopo province, Van der Walt (2005) found that reasons provided for their failure are poor management, lack of training, conflict among members and the lack of funds, and operations never started after registration.

When the new ANC led government came into play in 1996, inequality was viewed as one of the main challenges and issues to be dealt with (ANC, 1994). Thus, the growth and support of co-operatives, especially among historically disadvantaged South Africans, was taken as a strategy to alleviate poverty and create jobs (Mpahlwa (2005) and Philip (2003)). In light of such endeavours, the Cooperative Act, Act 91 of 1981 was considered to be unsuitable to achieve such a strategy mainly because (Ortmann & King, 2007b);

- the focus was too much on large, commercial agricultural co-operatives only
- the definition of co-operative was not adequate
- compliance with co-operative principles was not explicitly required from cooperatives
- the registration process was complicated
- members' interested were not sufficiently protected.

Based on these shortcomings and the need to enforce cooperatives as a strategy to fight poverty and create jobs, the Cooperatives Act, Act 14 of 2005, which is mainly characterized by the following purpose and provisions was passed (DTI, 2008);

- A wide variety of primary cooperatives can register in terms of this Act (including agricultural, consumer, housing, worker, financial services, burial society, and service cooperatives), as well as secondary cooperatives (formed by two or more primary cooperatives to provide sectoral services to its members) and tertiary cooperatives (whose members are secondary cooperatives, and whose objective is to advocate and engage state institutions and the private sector on behalf of its members).

- Enable co-operatives to register and acquire a legal status separate from their members and facilitate the provision of targeted support for emerging co-operatives, particularly those owned by women and black people.
- Promote equity and greater participation by black persons, especially those in rural areas, women, persons with disability and youth in the formation and management of co-operatives.
- Facilitate the provision of support programmes that target emerging cooperatives.

Despite being introduced recently, the Cooperatives Act 2005, Act 14 of 2005 was criticised for its limitations and the failure to take note of international cooperative trends (Agricultural Business Chamber (2008) and Lyne & Collins (2007)). Lyne and Collins (2007) argue that the Cooperatives Act 2005, Act 14 of 2005 perpetuates the notion of traditional co-operatives, ignoring trends in developed countries where co-operative legislation has been amended to encourage investment by patron and non-patron members. Admittedly, trends originating in developed nations may not be appropriate in developing countries, but the underlying problems that these changes aimed to address will also constrain development-oriented co-operatives in South Africa. This notion is further stressed by the Agricultural Business Chamber (2008) who state that their argument to reconsider such issues were not considered when passing the ACT as the argument turned political. However, experience from developed countries and in most commercial cooperatives in South Africa indicate that traditional co-operatives always come short at raising sufficient capital to finance investments needed to compete in the changing and competitive global food markets because of their institutional arrangements discouraged equity investors (Agricultural Business Chamber, 2008).

3.4 Cooperative thinking, nature and essence

3.4.1 Development imperative

Even though the existence or formation of cooperatives is argued to be motivated by economic reasons, there is wide acknowledgement that cooperatives are founded as a development or social reforming institution (Birchall (2003); Hagerman (2005); Krivokapi-Skoko (2002); Mooney & Gray (2002); McKee (2006)). The key drivers to the formation of the Rochdale cooperative and earlier cooperatives appears strongly to have been motivated by the developmental need of the members at the time by protecting and assisting its poor members to survive the rising prices (Birchall (2003) and Van Nierkek (1998)). Birchall (2003) also states that cooperatives were viewed as a revolution to the capitalist system of the time. The Rochdale cooperative principles illustrate a cooperative as development oriented and as a means of reducing poverty. Because they were open to new members, did not require people to invest large amounts of capital, and tended to share economic results equitably, cooperatives were argued to have a tendency to benefit the poor. Thus their development imperative was potentially strong as compared to other forms of economic organization, especially if their values and principles were respected.

The Rochdale principles have since been changed and most cooperatives are adopting cooperative principles as stated by the International Cooperative Alliance (ICA, 2008). The new cooperative principles still regard a cooperative as a development organisation but also emphasise the need for cooperatives to be economically viable if they are to satisfy their development imperative (ICA, 2008). Thus the commercial imperative is not viewed as the primary goal of the cooperative but the means to assist members and member communities to be developed. Birchal (2003) states that the origins of the now successful cooperative credit banking and agricultural cooperation in Germany started as a bid to distribute food to the desperate farmers around the 1840s. In Denmark, Canada and the United States, agricultural cooperatives enabled a whole class of small farmers to reach export markets whereas throughout Europe, Raiffeisen-type rural cooperative banks were providing a means of saving and borrowing for farmers (Birchall, 2003). New generation agricultural cooperatives in the United States have created wealth for poor farmers in the Mid-West through adding value to members produce (McKee (2007) and Altshul (2002)). Urbanchuk (2007) states that the impact of cooperative ownership of ethanol production in the USA is as much as 40 percent larger than the impact of an absentee owned corporate plant to the community. Various other studies indicate the development imperative of cooperatives (see Altshul (2002); Cooperative Care (2002); Munkner (2001); Murray (2006); Patel (2001); Parnell (2001); Taylor *et al* (2002)).

In the context of South Africa, there has been a resurgence of the co-operative movement with a strong focus on the emerging cooperatives. Cooperatives are acknowledged as an organization that could empower the poor and address the challenges of unemployment (Mpahlwa (2005) and Philip (2003)). Barraket (2001) gives a comprehensive view of the role cooperatives play in community development or revitalisation. FAO (2001) and Munkner and Shrestha (1999) show that milk cooperatives in Bangladesh have been instrumental in poverty reduction among the landless and small or marginal farmers. Birchall 2003 shows the role that cooperatives have played to the tribal communities (Tribal communities are among the world's poorest people). Ruben and Lerman (2004) argue that despite the relative merits of individual farming to cooperatives in Nicaragua, peasants still patronize cooperatives because cooperatives assist in addressing uncertainty associated with land ownership as well as to capture the benefits of rural development programs. Other notable studies of cooperatives in developing countries include those by Cabo and Rebelo (2006), Francesconi and Ruben (2007), Gertler (2001), Glasbergen (2000), Maharjan and Fradejas (2006), Nickson (2000), Schwettmann (2001), Parnell (2001) and Zeller (2006)). Despite the above arguments, Munkner (2001) argues that cooperatives often do not benefit the poorest of the poor because they need members who are able to pool their resources in order to reach a common goal which could be out of reach for the poor.

3.4.2 Political imperative

In their historical origin, cooperatives were clearly also political institutions. Birchal (2003) and Van Nierkek (1998) show that the motivation of the Owenites and the formation of the Rochdale cooperatives appears to have been motivated by the need to fight the capitalist system of the time. As a result, the development of cooperatives generated intense political opposition from competing economic interests. Ruben and Lerman (2004) state that cooperatives can only succeed in the right environment, as their success or failure was affected by the culture, the politics, the system of land tenure, level of education, and prevailing ethical standards in a country. In addition, Birchall (2003) indicates that the political structures within a country frequently influenced cooperatives or used them to justify political means.

The political imperative of cooperatives is also best illustrated by Olson (1960) through the Kirkpatrick type of cooperatives. The cooperative was controlled by a legally separate political and lobbying organisation not by the patrons themselves. For example, the Illinois agricultural association, held all the voting stock in the cooperative business and mutual insurance companies that were associated with it. In another case, the cooperative marketing, supply and insurance companies associated with the Farm Bureau in Illinois were run by an organisation that was legally and completely separate. The organisation had legislative and lobbying objectives rather than the business or economic objectives cooperatives and mutual insurance companies normally had.

Olson (1960) states that the system was set up in such a way that the business purposes of the purely economic parts of the system would always be completely subordinate to the political part of the system. Thus even if cooperatives had their own objectives, they could not escape the political influence and could be used to pursue political objectives. Political and lobbying organisations usually had enough strength and influence to attract membership. For example the farm bureau did not allow some of the business enterprises to sell their products to anyone who was not and would not become a member of the political organisation (Olson, 1960). Farmers therefore realised that they were bound to lose out patronage dividends or other non collective business benefits and a lot of money if they did not join such political groups.

In South Africa, cooperatives have been used as a political tool. The era of control boards under the Marketing Act of 1937 and the biased support of the land bank indicates the political imperative of cooperatives. The political environment at the time was biased towards furthering the interest of whites as opposed to blacks (Van Niekerk, 1998). During the era of control boards in South Africa, white commercial agricultural cooperatives were the main organisations employed as agents for the control boards, they also received favourable financial support from the land bank. In addition, further political bias is illustrated by the allocation of low interest loans to cooperatives which were not offered to other business organisations.

Cooperatives have shown that they require enabling legislation to be successful, for which they need political influence. Ruben and Lerman (2004) show that in Nicaragua, under the Soviet system cooperatives were taken over by the state or reduced to be mere agencies of the government, whereas under fascist dictatorships, they were taken over, their assets stripped, their leaders murdered, imprisoned, or exiled. Birchall (2003) shows that agricultural cooperatives began a close relationship with government in many countries, regardless of ideology; as shown in the United States, Japan, the Republic of Korea, India, France e.t.c.

Agriculture was seen as too important a part of national economies to be left entirely to market forces and thus warranted political intervention especially in light that cooperatives were often the preferred alternative to capitalist owners who might exploit natural monopolies in the food production chain.

3.4.3 Commercial imperative

Barton (1989), Cook (1995), Hind (1997), Henehan and Anderson (2001), and Schrader (1989) suggest that cooperatives have a strong commercial imperative and their motivation is economic. During the Rochdale cooperative era, cooperatives were means by which individuals could acquire lower purchase prices, higher sales prices, and larger cash dividends (Birchall, 2003). Though such motivations could have been developmental or political there is a strong sense of the economic need of the individuals at the time. Cook and Chaddad (2000), Fulton and Giblings (2000) and Krivokapic-Skoko (2002) show that globalization and agro-industrialisation has increased competition and resulted in a changing market environment. Thus, to be successful, cooperatives just like any other organisation have had to adopt their organisational structure or strategies. Of major note is that it has led to a conflict on how to balance the cooperatives` duty to maximise cooperative member individual benefits and interests yet being be a profitable, well-financed and a growing business which is core to survival in today's business environment.

Cook and Chaddad (2000) state that strategies to build a competitive edge can comprise engaging in value-added processing, brand name development, and entry into international markets, e.t.c. These strategies have been shown to result in more capital intense, larger and more often commercial oriented cooperatives in order to finance such actions. The key issue for co-operatives has been shown to be running successful businesses while adhering to the co-operative principles (ICA, 2008). Although the primary goal of a co-operative organisation is to provide a service to members and not to maximize profits, co-operatives have come under pressure to be profitable or at least generate sufficient revenue to cover expenses, lower costs and ensure its survival and growth. Thus cooperatives appear to have a strong commercial imperative.

Piesse *et al* (2004) argue that grain cooperatives in South Africa are now market oriented and behave more like companies. Initially, cooperatives were used as instruments of government policy, but when the agricultural sector was deregulated many cooperatives disappeared, whilst those with strong leadership and good management began to prosper as autonomous businesses (Van Niekerk, 1998). In addition, Piesse *et al* (2004) show that cooperatives have responded by changing the focus of their activities and increasing their economic efficiency.

Cote *et al* (2000), Evans and Meade (2005), and Henehan and Anderson (2001) state that the primary underlying motivation to form a cooperative is basically the same as forming any other business. However, in an investor oriented firm (IOF), an individual investor seeks out an investment opportunity yielding the greatest growth potential or highest return on investment possible and often they will have little or no direct involvement in the business itself, other than as a shareholder. On the contrary, the prospective member-owners of cooperatives are frequently not simply seeking the highest possible return on their investment, but a set of returns associated with becoming a member which may include services, better prices, user control, access to markets, along with a return on capital invested (Henehan and Anderson, 2001).

Cooperatives have also been shown to grow to an extent that they behave more like commercial oriented units. For example, approximately 60% of the French banking sector is formed by co-operatives and mutual associations, which are very successful businesses while remaining true to the values of the co-operative movement (ICA, 2008). But it is clear that there would not be successful businesses if they had not embraced some commercial imperative concepts. ICA (2008) argues that the unique characteristics that differentiates cooperatives from other enterprise structures is its dual nature that is they are business enterprises based on a membership-owned model. Thus cooperatives are an alternative organisation pursuing successful commercial business practices based on the values of self-help, self-responsibility, solidarity, user control and democracy.

3.5 Summary: Are cooperatives relevant or obsolete

Changes such as increased competition, changing policies, changing consumer profiles, interests or tastes are becoming too evident (Kyriakopoulos *et al*, 2004). As such, business organizations are forced to adopt their organizational structures and strategies to match such changes (Cook and Chaddad (2000); Evans and Meade (2005); Heit (2007); Kyriakopoulos *et al* (2004); O'Connor (2001) and Sykuta and Cook (2001)). Cooperatives are hence forced to pursue competitive strategies and be dynamic in response to structural and other changes in the market place. Clearly, such trends indicate a move towards more competitive oriented business models. Van Nierkek (1998) argues that the primary objective of cooperatives is to facilitate economic interaction through collective action and enabling members to gain access to a certain market service or asset, take advantage of economies and partake in activities they would never afford or manage individually. Thus a co-operative has inherent objectives of assisting members to enable them to earn profits in their own right but not for the cooperative to necessarily become a profit organization. Therefore the development imperative of co-operatives is achieved through the facilitation of economic activities by the empowerment of members to participate as businesses.

An organization with a purely social or development objective would focus on service delivery for no gain or profit. This is especially true for where the market system fails and does not provide a specific service and where the community consequently comes together to provide that service collectively and in this way also enhances the general livelihood and alleviate poverty within the community (Birchall, 2003). This was the case in earlier formations of cooperatives around the world (especially the Rochdale period) and in some parts of the developing sector of the South African economy. However, in today's competitive business environment, challenges to sustain the organisation and enable it to service its members has meant that cooperatives are under pressure to adopt a commercial approach and behave like viable business organisations in order to meet the members` needs (Ortmann & King (2007a, b)).

Given the above insights, are cooperatives still relevant? Firstly because of their essence, cooperatives have a social objective to a certain extent, thus tend to get captured by the government, and are used as instruments of government policy where they get bureaurocratised and in the end lose their efficiency and effectiveness. Some of the government actions emanate from the strong and sound argument of the role cooperatives can play in development. However, if the socialist agenda or their development imperative is allowed to dominate without a closer concern for their sustainability, co-operatives then become irrelevant as economic entities. Conclusively, in order for commercial cooperatives to be relevant as commercial and economic entities, South Africa needs to adopt business conducive and supportive policy as has been the case in developed countries such USA, Netherlands, and Canada e.t.c.

CHAPTER FOUR
ORGANISATIONAL PERFOMANCE:
DYNAMISM AND FINANCIAL PERFOMANCE

4.1 Introduction

Chapter four discusses the literature on organisational dynamism and financial performance. Profitability, liquidity, solvency, efficiency and growth ratios are used as the key financial performance measures to compare agribusiness performance, taking into consideration the inherent differences between cooperatives and companies. In addition, dynamism as shown by the firms` management, organisation strategies organisation culture will be discussed in this chapter. Dynamism is an important determinant of business performance and explains how organisations adapt to the dynamic business environment and why some businesses organisations perform better than others.

4.2 Organisational performance

4.2.1 Financial performance

Financial performance is fundamental to the success and sustainability of any business. Despite several measures of success that business organizations strive for such as status, market share e.t.c., the bottom line for any business is to be financially successful, otherwise the business becomes unsustainable in the long run (Boehlje *et al* (1999); Davidson (2005); McKee (2006); Miller *et al* (2001)). The key financial performance measures that are mainly used by most businesses are profitability, liquidity or solvency, efficiency and growth ratios. These measures are discussed in table one.

Due to the differences in the nature and essence of companies and cooperatives, their comparative financial performance is argued to have different interpretations and expectations (Kyriakopoulos *et al*, 2004)). Traditionally, profitability is thought to be the real economic goal of the firm. Cooperatives are not considered to be return on investment maximizers like companies, their members traditionally expect to receive their returns in the form of improved market access or lower input prices, rather than a direct return on their equity investment in the cooperative (Henehan, & Anderson (1989); Henehan, & Anderson (2001)). In addition, Kyriakopoulos *et al* (2004) state that cooperatives operate differently from companies because of the three basic cooperative principles that define the essence of a cooperative organisation mainly: user-owned, user-benefit and user-control. These service benefits reduce the cooperatives' return on investment by lowering revenues and increasing costs. Comparatively, companies have a clear objective to maximize profitability because of their built in goal of maximizing shareholder value. Mixed evidence has been found regarding this interpretation (Evans & Meade, 2005). Some cooperatives have been shown to outperform companies in terms of profitability (Boyle (2004); Babb & Boynton (1981); Hardesty & Salgia (2004); Lerman & Parliament (1990)). In addition, in today's challenging business environment, cooperatives have been pressured to be profitable in order to best serve their members interest.

Both cooperatives and companies aim to achieve financial growth over time. However, expectations are that cooperative growth is constrained because of the inherent weaknesses of the cooperative business model, chiefly their constrained capacity to raise equity capital (Cook, 1995). Thus, as long as cooperatives are best serving the primary interest of their members, the expectations is that profit, revenue and asset growth are secondary. The same concept applies with regard to the liquidity and solvency ratios of the cooperative. However, because of the challenging business environment, both companies and cooperatives are expected to maintain sound and sustainable liquidity and solvency ratios. Finally, because cooperatives have the ultimate drive to service members in the best way possible, they search for the best ways to provide services or products in the cheapest way possible even though this could be beneficial to the members it could lead to the inefficiency of the cooperative as an organisation (Porter & Scully, 1987). On the other hand, companies have the ultimate drive to be efficient in order to perform and increase profitability.

Despite the relative importance of financial performance measures it is necessary for business organisations to develop a benchmarking tool that provides goals for realistic improvement and helps the business to understand the changes required for improving financial performance (Porter (1980) & PWC (2006)). Benchmarking is important mainly because it (O'Dell (1993) & Watson (1992));

- Provides a reliable way of assessing the relative performance of the business.
- Improves strategic planning and provides an assessment of the organization's strengths and weaknesses
- Establishes challenging performance goals and stimulates better performance

It is of great importance to choose the appropriate type of benchmarking. The following describe the benchmarking methods that can be used (O'Dell (1993) & Watson (1992));

- **External benchmarking** identifies organizations providing similar products or services and compares their results. The study uses external benchmarking as calculated by the PWC agribusiness benchmarking survey.
- **Internal benchmarking** compares an organization's own similar processes or products. This is the easiest type of benchmarking to perform, but is limited to the organization's best internal practices. It should be considered as a means of establishing a baseline performance that will later be used for comparison to external performance and to identify the scope of improvement opportunities
- **Analogous benchmarking** is considered the most difficult and most desirable type of benchmarking as comparison is made with a world-class organization which may be performing a similar process but in a different field. Such organizations are hard to identify and may require adjustment in accounting and other practices

4.2.2 Organisational dynamism

Organisational dynamism refers to the ability for organisations to respond to the unpredictable and rapidly changing business environment (Ensley *et al*, 2006). Organisational dynamism has a significant impact on performance. In today's dynamic environment, organisations have to be dynamic and embrace changes with speed and comprehensiveness to be successful (Leach, 2003). Organisation dynamism is shown by the changes the organisation undertakes in response to or in anticipation of market changes (Priem *et al*, 1995).

Ensley *et al* (2006) indicates that in today's modern dynamic environment, organisations that consider more alternatives tend to outperform those who do not. Thus flexibility in decision making is important for organisational dynamism. Eisenhardt (1989) found that the behaviour of effective decision makers working in dynamic environments is characterized by speed and comprehensiveness. These results suggest that effective decision makers maintain sophisticated information search and processing routines, whereas less effective decision makers resort to using less complex routines to cope with the time pressure and stress that is brought about by the uncertain and rapidly changing environmental conditions. Because the decision making function is mainly allocated to management, dynamisms can best be explained by looking at management behaviour (Porter, 1991).

The culture, structure and strategies of the business model also affect organisational dynamism and are discussed in the next section. However, for organisational culture, structure and strategies and management to be effective in the organisation, the policies and business environment have to be appropriate. For example, the deregulation of markets and withdrawal of state support in South Africa put pressure on organisations to be dynamic. However, even dynamic organisations are battling to adapt to new regulations such as the new Cooperatives Act (Act 14 of 2005) that limit cooperatives to adopt modern cooperatives model. Secondly, an amendment to the Petroleum Products Amendment Act has seen most agribusinesses denied PPAA licensing even though, acquiring such licensing is a response to the changing environment.

4.2.2.1 Organisational culture, strategy and structure

Organisational culture is defined as the shared beliefs and values that shape the attitudes of members, guides behaviours at work and influences the behaviour, performance goals and aspirations of members (Schermerhorn *et al*, 2005). Establishing the correct and appropriate organisational culture is an essential process of managing an organization. Organisations with strong culture operate with a clear vision of the future that is supported by well developed and well communicated beliefs and values. According to Schermerhorn *et al* (2005) high performance organisations have value driven cultures that emphasise the following values; information sharing, teamwork, empowerment, participation and continuous learning. Schermerhorn *et al* (2005) based on an approach for mapping organisational culture, categorise organisational cultures into three categories; (i) passive/defensive cultures, (ii) constructive cultures and (iii) aggressive/defensive cultures as shown in Figure 3. In constructive cultures members are encouraged to work together in ways that meet higher order human needs. This has been found to be the most effective culture because workers tend to work with greater motivation, satisfaction, teamwork and performance. In passive/defensive cultures, members tend to act defensively in their working relationships, seeking to protect their security. In aggressive/defensive cultures, members tend to act forcefully in their working relationships to protect their status. In passive/defensive or aggressive/defensive cultures motivation tends to be lower and work attitudes less positive, thus resulting in poor or reduced performance.

Figure 3: Different organisational cultures

MORE EFFECTIVE

PASSIVE/DEFENSIVE CULTURES

Members are defensive in their actions

- Approval
- Conventional
- Dependant
- Avoidance

LESS EFFECTIVE

CONSTRUCTIVE CULTURES

Members are helpful in their interactions

- Achievement
- Self actualising
- Humanistic encouraging
- affiliative

AGGRESSIVE/DEFENSIVE CULTURES

Members are forceful in their interactions

- Oppositional
- Power
- Competitive
- perfectionist

LESS EFFECTIVE

Source: Schermerhorn *et al* (2005).

Schermerhorn *et al* (2005) argue that because we are not born with a culture but we are born into a society that teaches us culture, there is a strong need for organisations to build cultural intelligence amongst its workers. That is encouraging an environment where members indentify, understand and act sensitively and effectively to the culture of the organisation. Although, much of this can be affected by individual personal factors such as family, race and religion, organisational culture can be nurtured in an organisation. People learn to perform certain behaviours through either the rewards or negative consequences that follow their behaviour. When behaviour is rewarded, it is repeated and eventually becomes part of the culture.

The structure of the business model also affects organisational dynamism. Ownership issues and how the business is organised clearly indicate how dynamic an organisation is. Li and Simerly (1998) found that, in dynamic environments, high performing firms tend to be managed by individuals holding an ownership stake in their company. This is mainly because ownership unifies top management to work together towards a common goal. Management without an ownership stake is more likely to be fragmented by individual agendas. Ownership and control rights are discussed in more detail in chapter five.

In the ever changing business environment, organisational strategies should reflect and highlight the unique circumstances that will affect the firm's future. Questions that arise about the organisations` strategy include, (i) the firms' role and level of participation in corporate social investment, (ii) the nature of environmental sustainability or eco sensitive initiatives, (iii) nature of investments, (iv) the restructuring actions it has or is considering undertaking, (v) the BEE score, (vi) accounting reporting method, (vii) changes in customers, (viii) changes in product mix or services and value addition? These questions define how an organisation will differentiate itself from its competitors and how well they are adapting to the dynamic environment (Kyriakopoulos *et al*, 2004).. In addition, these issues are and will continually shape how businesses in South Africa build competitive advantage through their strategies.

Rowe (2005) states that four hundred years earlier, social responsibility shifted from the church to the state, as government replaced religious institutions as society's predominant force. The current trend and expected future trend is that business organisations are more than likely to take over this responsibility. Various arguments and criticisms have been raised against corporate social responsibility (Friedman (1970); Orlitzky *et al* (2003); Rowe (2005); Williams & Aguilera (Undated)). The biggest question being whether business can meet social, environmental and responsibility still win financially. However, Porter and Kramer (2006) present a strong argument that when looked at strategically, corporate social responsibility can become a source of tremendous social progress as the business applies its considerable resources, expertise and insights to activities that benefit society because successful organisations need a healthy society. Porter and Kramer (2006) argue that dynamic organisations prioritise social responsibility into generic social issues, value chain social impacts and social dimensions of competitive context[2].

4.2.2.2 Management style and culture

It is widely acknowledged that it's important for a company to have a good management team because it is the backbone of any successful organisation. The main importance of management emanates from its responsibilities to make strategic decisions and leading the

[2] Generic social issues may be important to society but are neither significantly affected by the company's operations nor influence the company's long term competitiveness. Value chain social impacts are those that are significantly affected by the company's activities in the ordinary course of business. Social dimensions of competitive context are factors in the external environment that significantly affect the underlying drivers of competitiveness in those places where the company operates.

company. However, evaluating management is difficult because so many aspects of the management job are intangible. Hambrick and Mason (1984) state that there is no magic formula for evaluating management, but there are factors to pay attention to. Management culture and style, management competence or ability and management incentives are discussed in this study as they relate strongly to management performance and ultimately organisational performance.

Management styles can best be explained by the way management manages relationships with other stakeholders and the manner management leads the company **(**Sashkin & Morris, 1984). According to Benfari and Knox (1991), differences in management styles occur in four critical areas, (i) How managers perceive and judge the world around them (ii) how managers gain a sense of personal satisfaction and competence (iii) how managers handle conflict, and (iv) how managers use power. As a result, there are various ways to describe management styles. Autocratic management styles describe management that typically tends to centralise authority, dictate work methods, make unilateral decisions and limit subordinate participation. Democratic management styles describes management that tends to involve subordinates in decision making, delegates authority and use feedback as an opportunity for coaching subordinates. The lassez faire management styles generally give the group complete freedom to make decisions and complete the work in whatever way it sees fit (Robbins & Coulter, 1996).

Management styles may also be determined by the characteristic of management. For example a quiet or behind-the-scenes management style, out-front, take-charge type, a formal as opposed to an informal relaxed style. Transactional management style is focused on motivating the behaviour of subordinates through exchange processes, such as administering rewards and punishments. In doing so, transactional management style capitalizes on the self-interests and extrinsic motives of their employees. On the other hand, transformational management style is focused on motivating followers by appealing to their ideals and intrinsic motives. Transformational management style inspires others to adopt the vision of the organization as though it were their own and to focus their energy towards the accomplishment of higher level goals, rather than the attainment of rewards or avoidance of punishments (Sashkin & Morris, 1984).

Management style should be adapted to suit the generation of employees at the workplace. Conger (1997) indicates that there are three generations working in today's organisation, the silent generation, baby boomer generation and the generation X. These generation shifts play a significant role in shaping how employees of the organisation prefer to be managed. In today's working environment, clearly a more informal, team and persuasion based management style will succeed with the baby boomers and generation X as opposed to the formal style with a clear distinction between management and employees that worked well with the silent generation (Conger, 1997).

Management styles can be translated to the management culture of the organisation. If the management culture is not hierarchical, the line of command between the boss and the employees is short, and in principle everyone, regardless of education, position or social status is regarded as equal (Christine, 2006). Thus management listens to its staff and is willing to take advice because they see them as specialists in their own fields. It is common to find management taking lunch with the staff and standing in the same queue in the canteen. The opposite is true for a company with a hierarchical management culture where there is clear distinction between management and other staff.

4.2.2.3 Management competence or ability

According to Mann (1965) there are four managerial skills that are essential for management to carry out their duties well. Technical skills which are needed to perform specific tasks; interpersonal skills which are needed to effectively manage interpersonal relations; administrative skills which are needed to plan, organises, coordinate and effectively do duties that are assumed to be managers normal responsibilities and institutional skills which are required if the manager is to effectively represent the organisation to other organisations and to society at large. These are discussed in more detail in Table 3. However, different managerial positions require different degrees of each of the basic four skills. At the executive level, institutional skills, interpersonal skills and administrative skills are by far the most important. Whereas at mid management level, a balance of the four skills is important although with much emphasis on the interpersonal skills and administrative skills. At a supervisory level, technical skills, interpersonal skills and administrative skills are crucial.

Table 3: Mann's four skills

TECHNICAL SKILLS

The ability to use knowledge, methods, techniques, and equipment necessary for the performance of specific tasks and activities. These may be acquired through formal training in professional skills, informal on job training or combination of school and apprenticeship programmes

HUMAN RELATIONS/INTERPERSONAL SKILLS

The ability to use pertinent knowledge and methods for working with people. Includes an understanding of general principles of human behaviour, particularly those that involve interpersonal relations and motivation, and the use of this understanding in day to day interaction with others in the work situation. The supervisor with human relations skills understands how the principles of behaviour affect not only others but himself too. He knows hoe both his own frame of reference and that of others colour what is perceived and assumed in reality; how attitudes, beliefs, opinions and values affect behaviour and learning, and how needs and aspirations shape an individual's investment of his energies. Included in these skills is the ability of members at different levels in the organisation to represent their needs and goals to each other so that each can comprehend the problems faced by the other. Central to human relations skills is the ability of the supervisor to integrate the goals of individual with the objectives of the organisation. The supervisor must be able to identify the needs of others that are central to the self concept and to relate these to organisational objectives in a manner that is psychologically meaningful and rewarding to the specific individual. Basically, this area of skills involves managing the emotional and motivational dimensions of interpersonal relations and organisation.

ADMINISTRATIVE SKILLS

The ability of the manager to think and act in terms of the organisation within which he operates; the functions and tasks that he must fulfil in order to effectively perform his job relates to the tasks and goals of the organisation. Administrative skills include planning, organizing, assigning the right tasks to the right people, giving people the right amount of responsibility and authority, inspecting and following up on work, and coordinating the efforts and activities of different organisation members and departments

INSTITUTIONAL SKILLS

This set of skills involves representing the organisation as a whole in interaction with the other organisation, groups, government agencies, and so on, that form the environment of the organisation. People differ in their ability to see, think clearly about, appraise, predict and understand the demands and opportunities posed to the organisation by its environment. If a leader is seriously mistaken about the requirements or needs of the organisation, or about the demands of the environment, his interpersonal and administrative skills may become liabilities to the organisation. It is worse to be wrong and influential than to be merely wrong. It is the top level executive who needs these institutional skills the most. Part of this category of skills is an external perspective- an accurate and comprehensive view of the organisation environment relationship – which includes sensitivity to environment demands and opportunities (the possibilities of achieving a more advantageous relationship with the environment) and sensitivity to trends and changes in the environment.

Source: Mann (1965) in Sashkin and Morris (1984).

Hambrick and Mason (1984) suggest that heterogeneous top management teams perform best in dynamic environments, whereas homogeneous teams perform best in more stable environments. Hambrick and Mason (1984) argue that diverse teams are more capable of making sense of ambiguous situations than are less diverse teams, which are likely to operate with a more narrow perspective. Priem (1990) also shows that the level of consensus within top management teams will likely relate to performance such that low consensus teams will perform best in dynamic environments, whereas high consensus teams will perform best in stable environments. In support of these complimentary views, a study by Homburg *et al* (1999) found that top management team consensus tends to have a lower impact on performance in dynamic rather than stable environments.

4.2.2.4 Management incentives

Business organisations use various management incentives to enhance performance (Demsetz, 1983). The most commonly used management incentives are mainly the (i) share option, (ii) profit share, (iii) incentive bonus and (iv) honorary rewards or non financial recognition. Share options have long been used as an incentive to ensuring that management increases shareholder value. Demsetz (1983) indicates that when management owns a measurable proportion of its shares, it serves as good enough incentives for high performance and better management as they are not only managing the owners interest but their own as well. Demsetz (1983) argues that share options are a good incentive for management not to shirk. In addition, when management have share options, it is much easier to read their actions concerning the value of shares and future expectations. However, there are cases or dangers for management to do whatever it takes to drive up the share price so they could vest their options to make quick returns at the expense of long-term investors.

Profit shares guarantee management a certain specific portion of profits if the company performs well. Thus profit shares serve as a performance incentive because if the company is performing well then management also gets a good share of the profit. However, profit shares also suffer from the same weakness of management driving to increase high profits even if it means incurring high debts that could affect the company in the long run. Incentive bonuses are also another form of financial compensation management gets for good performance. Other companies use non financial recognition such as honorary rewards as management incentives to encourage performance. Though not financial in nature and argued not to offer incentive enough to encourage performance, these non financial recognitions can encourage performance especially if they are highly valued in the organisation for other opportunities such as promotion.

4.3 Summary

- Financial performance is fundamental to the success and sustainability of any business

- Benchmarking is important to provide goals for realistic improvement and help the business to understand the changes required for improving financial performance
- The study uses external benchmarking as calculated by the 2006 PWC agribusiness benchmarking survey.
- Organisational dynamism refers to the ability for organisations to respond to the unpredictable and rapidly changing business environment.
- There are various factors that affect organisation dynamism, however, four main factors are discussed in this chapter, which are management styles and culture, management competence, organisation culture and strategies
- Establishing the correct and appropriate organisation culture is an essential process of managing an organization
- Organisational cultures are categorised into three; (i) passive/defensive cultures, (ii) constructive cultures and (iii) aggressive/defensive cultures. In constructive cultures members are encouraged to work together in ways that meet higher order human needs. This has been found to be the most effective culture because workers tend to work with greater motivation, satisfaction, teamwork and performance
- A strong management is the backbone of any successful company and thus it is widely acknowledged that it's important for a company to have a good management team
- Management styles are important to business because they are linked to the success of the business and in other cases can be translated to the management culture of the organisation.
- Management incentives and compensation ((i) share option, (ii) profit share, (iii) incentive bonus and (iv) honorary rewards or non financial recognition) has been shown to have a strong link with performance and thus organisation performance
- Conclusively, organisational dynamism and organisational culture as well as management competence, ability, culture, style and incentives can explain why some businesses organisations perform better than others.

CHAPTER FIVE
PROPERTY RIGHTS APPROACH

5.1 Introduction

The main objective of the chapter is to provide an understanding of organisational restructuring and provide insight of the cooperative business model and its differences to other business models mainly the investor oriented company. The property rights approach is mainly concerned with how the assignment of and costs of transferring property rights affect incentives and economic outcomes (Furubotn & Richter, 2000). Furubotn and Richter (2000) state that the structure of property rights is important because it affects transaction costs, incentives and economic behaviour. Blair (1995), Demsetz (1988), Demsetz (1997), and Chaddad and Cook (2004) show the importance of well defined and enforced property rights for the success of business. Property rights are important because they influence incentives, affects stakeholder behaviour and thus economic outcomes of businesses.

Organisational structures with well clearly defined property rights are argued to do better than organisational structures with ill defined property rights (Chaddad and Cook, 2004). Demsetz (1967) proposes that market forces push economic organisations in the direction of efficiency by eliminating inefficient property right structures and promoting the introduction of new arrangements that are better adapted to the economic challenges and opportunities. However, Sugden (1989) argues that property rights have emerged over time by convention (or through the operation of the invisible hand) and that the structures that have evolved need not be efficient. Demsetz (1988) shows that the efficiency of the firm is argued to depend on how well its members (including those who supply inputs or are within the enterprise) are able to blend their efforts and cooperate effectively. Thus the key issue for organisational economics is to determine how to motivate individuals so that they will work towards collective interests and make the firm successful through well defined and properly assigned property rights (Demsetz (1988) and Demsetz (1997)).

5.2 Background on the property rights framework

5.2.1 Ownership rights

Furubotn and Richter (2000) state that when there is uncertainty and asymmetrical information, ownership of resources matter for economic results. Alchian and Demsetz (1972) define ownership as the possession of the (i) rights to be a residual claimant, (ii) rights to observe input behaviour (iii) rights to be the central party common to all contracts with inputs (iv) rights to alter the membership of the team, and (v) the rights to sell these rights as desired. Ownership rights are argued to affect economic incentives and behaviour which affects the economic performance of the firm (Demsetz, 1988). It is important that ownership rights should be able to assign the costs or benefits associated with any individuals' actions or behaviour on that individual. Well defined ownership rights should take into account the costs an individual can cause by attempting to maximise or minimise the present value of benefits or costs respectively, at the expense of the organisations future or other individuals. When the full costs or benefits of an individual's activity are borne to him, this creates an incentive to utilise resources more efficiently and results in efficient maximising decisions.

The critical questions ownership rights have to address are (i) who owns the firm? (ii) what does ownership of a firm mean? (iii) does it matter whether the firm is owned by those who invested capital in it, by its workers or by the state? These issues are critical because the identity of owners, the content of the bundle of ownership rights and the structure of ownership has consequences on decisions made and hence the outcome or efficiency of the firm (Demsetz, 1988). Ownership rights in firms tend to be described by the way shares entitle the rights to the holders. Thus different firms can differ in the way shareholder rights are allocated as shown by how claims are made to the firms income, dividends entitlement, what is expected of shareholders and the rights to transfer such ownership.

Demsetz (1988) indicates that the costs of negotiating and monitoring ownership rights increases with number of owners. Even though a large number of owners can be justified by the benefits to economies of scale and the equity capital that can be raised from these shareholders, Demsetz (1988) argues that economies of scale in the provision of capital do not exist. In addition, if all owners participate in decision making, negotiating costs become high. As a result, when the scale of ownership rises, there is a growing need to employ management to make decisions on some aspects of the business. In principle, ownership means effective control, but when the organisation grows some control rights are allocated to management.

5.2.2 Control rights

Control rights refer to the ability and extent to exercise influence within an organization by making crucial decisions affecting the organization or relevant to its functioning (Demsetz, 1988). Demsetz (1997) states that control is not limited to the power and incentives of decision making but also to the wealth gain achievable through effective monitoring of managerial performance by the firms owners.

Control rights will differ depending on the organisational structure of the firm e.g. control rights are different for cooperatives, public owned, private owned, state owned organisations. In most organisational structures, shareholders own the firm and their ownership and shareholding comes with specified control rights. Individual shareholders or owners have control rights through their voting power in matters pertaining to the appointment of the board of directors and approving proposals for fundamental changes affecting the firm such as liquidations, mergers, acquisitions e.t.c. Depending on the firms structure of control rights or business model, the voting power can be based on the number, class or types of shares tied to the level of capital invested or in the case of traditional cooperatives, one member one vote principle. The importance of voting power is that individuals who possess a majority of shares and effectively have more voting power to dictate the firm's decisions, thus effectively controlling the firm. Therefore, control rights are important because they determine the decisions that the firm makes. Demsetz (1988) presents it as the incentive to control.

When the firm increases in size and scale, shareholders or owners cannot exercise all their control rights because the control function and activities grow beyond what an individual can handle (Blair, 1995). Thus some control rights are allocated to the board of directors and management. The board of directors basically supervises, oversees and controls the organisation through management. However, the important issues such as the strategy and objectives of the organisation usually remain the duties of the owners to decide or control. Because of delegation of duties, some control rights are allocated to management.

5.2.3 Agency problem

When organisations grow, ownership and control rights are usually separated. However, it becomes important to establish an appropriate property rights structure that will minimise the conflicts and costs incurred because of the separation of ownership and control by drawing up the appropriate incentives such that those granted control rights of the organisation, specifically management, serves the best interest of the owners (Blair (1995); Demsetz (1988); Demsetz (1997) and Furubotn & Richter, 2000)). The agency theory provides a framework to discuss the separation of ownership and control rights.

Agency theory assumes that there are two economic actors in each case, the principal and the agent. The principal engages the agent to perform services on his behalf. To facilitate the achievement of the activity, the principal delegates some decision making authority to the agent. Information is taken to be asymmetric in the sense that, (i) the agent's action is not directly observable by the principal or (ii) the agent has made some observation that the principal has not made (e.g. the true output of the firm). Furthermore, it is too costly for the principal to directly monitor the agent's actions or to acquire full knowledge of the agent's unique observational information directly. This could lead to moral hazard and characteristically, the agent will not act in the best interest of the principal (Furubotn & Richter, 2000). Based on such a situation, the agency theory shows the importance of appropriately structuring ownership and control rights in a firm.

Jensen and Meckling (1976), and Furubotn and Richter (2000) indicate that the principal can limit the agents` divergences from his interest by establishing appropriate incentives for the agent or alternatively by monitoring the uncharacteristic activities of the agent. In some situations, the principal can pay the agent to guarantee that he will not do certain actions which would harm the principal or alternatively insure that the principal will be compensated if the agent does take such actions (Furubotn & Richter, 2000). Agency costs vary from firm to firm as they depend on the tastes of managers (attitudes of agents), the ease with which agents exercise their own preferences as opposed to adopting behaviour that results to the maximisation of the owners residual, the agents degree of risk aversion, the costs of monitoring and bonding activities, as well as the organisational structure of the firm (Furubotn & Richter, 2000). Jensen and Meckling (1976) also indicate that agency costs depend upon the costs of monitoring the managers' performance and evaluating it, as well as the cost of devising and enforcing specific behavioural rules or policies.

Manne (1965) explains the concept of the separation of ownership and control by indicating that takeover threats represent the most efficient instrument for disciplining management. Basically, in a badly run company, the market price of shares would be comparatively low. Such a low current price of shares indicates the possibility of a more profitable future for the company provided its existing assets were managed more efficiently. Thus the company becomes an attractive target for takeover by individuals who believe they could improve its performance. Manne (1965) argues that the possibility of takeover threat is sufficient to solve the agency problem.

Agency problems can be limited by separating the management and control of decisions, thus restricting agents from having all the power at their disposal (Furubotn & Richter, 2000). In the case when monitors are selected to monitor the agent, there is the dilemma on who will monitor the monitor. Alchian and Demsetz (1972) argue that if the monitor possesses the title to the market value of the firm and all the gains or losses in the firm's market value can be assigned to the monitor, then there is no incentive to shirk. As a result, the best solution would seem to be to allow the monitor to become the full owner of the firm. Knott (1993) states that the market for management also influences the behaviour of managers, if the market for management is highly competitive, then incentives for managers to pursue their own interest at the expense of the owners are limited.

5.3. Property rights that constrain the growth of cooperatives

Various studies have been done on the property rights features of cooperatives (Chaddad & Cook (2004), Chaddad *et al* (2005), Cook (1995), Harvey & Sykuta (2005), Hendrikse & Veerman. (2001a, b), Ortmann & King (2007a, b), Sykuta & Cook (2001)). These studies clearly expose the inherent weaknesses of the cooperative model as a result of the ill defined property rights. The weaknesses of cooperative property rights seem to be a direct result of their imperative. If viewed as purely social or developmental institutions then the following property rights seem justifiable; (i) allowing for everyone to join the cooperative as long as they share the same principles and can afford the nominal sum for the equity membership fee, (ii) redeeming only the nominal value of the members nominal investment upon exit, (iii) one member one vote principle, (iv) restricting external investors to be members. However, once cooperatives grow in size and undertake activities in competitive markets that requires the cooperative to be highly competitive to survive, then cooperative problems as a result of ill defined property rights as described below emerge (Cook (1995); Chaddad & Cook (2004));

- **Free-rider problem;** Emerges when ownership rights are untradeable and not sufficiently well defined and enforced to ensure that individuals are responsible for the full cost of their actions or receive the full benefits they create. Chaddad and Cook (2004) distinguish between external and internal free rider problems. An external free rider problem arises when the benefits and costs faced by members and non-members are poorly aligned. For example, where a cooperative is successful in shifting the market price and terms for the inputs that its owners supply towards competitive levels (i.e. in an industry otherwise lacking competition), other non-member suppliers may get to enjoy the same price and terms without paying for membership.

An internal free rider problem arises when new members of the cooperative enjoy the same patronage returns as existing members, or can access the cooperative's capital without paying the full cost of the benefits they derive. As a result, other cooperative members effectively subsidise their entry. This dilution of existing member returns creates a conflict between new and old members, and a disincentive for older members to invest in the cooperative.

- **Horizon problem;** Arises when the owner-patron's claim on the cooperative's residual earnings is short lived when compared to the productive life of the cooperative. When benefits a member receives from an investment are limited to the period (horizon) over which the member expects to patronize the cooperative because his ownership claims cannot be traded at market value, cooperatives will tend to under-invest in assets with long-term payoffs such as research and development, and marketing (Harte, 1997).
- **Portfolio problem;** Occurs because member shares cannot be freely traded and the inability of owner-patrons to separate their ownership and patronage decisions. Therefore, members are unable to adjust their individual investment portfolios according to their personal wealth and preferences for risk, which could result in suboptimal investment portfolios. Faced with suboptimal investment portfolios, members will attempt to direct the activities of the cooperative in a direction that better matches their own risk-return trade off. This in turn means cooperatives face pressure from their owner-patrons to adopt investment policies that mitigate this owner-level lack of diversification, even when this is not optimal for the cooperative. In addition, potential outside investors, who could diversify the risks, are generally excluded from investing in a cooperative**.**
- **Control problem;** Any organization in which ownership and control are separate, will to some extent experience principal-agent problems due to divergence of interests between the principal and the agent. Because of this separation it is predicted that the interests of owners and managers will diverge, giving rise to agency costs. The absence of an equity market and lack of transferable ownership claims or shares with an observable current market value for cooperatives means that members are not able to monitor their cooperative's value or evaluate managers' performance resulting in operational inefficiencies being unnoticed. Such control problems are argued to worsen with cooperative size and complexity.

- **Influence cost problem;** The dual role of the member as owner and user could create a situation in which some members attempt to influence the cooperatives` decisions for personal benefits ignoring the costs of such poor decisions to the cooperative. Cooperatives may experience greater influence costs than other forms of organisations because the interests of cooperative members, who are linked to individual farm production activities, are more diverse than the interests of corporate shareholder who share a common objective of maximizing return on investments (Royer, 1999). The influence cost problem is further worsened if the cooperative's range of activities is wider or if there is great heterogeneity among its members giving incentives for interest groups to form and seek to influence the cooperative's decisions to their benefit even if it is at the expense of other members. Banerjee *et al* (2001) present evidence on the costs of such behaviour in Indian sugar processing cooperatives, where larger owners face an incentive to reduce the price paid on inputs, to the detriment of smaller suppliers, in order to increase their personal prestige.

5.4 Evolution of new cooperative models

The inherent weaknesses of traditional cooperatives have led to the evolution of new cooperative models in cases where policies and legislation have allowed such actions. Chaddad and Cook (2004) present a classification of cooperative models based on an ownership typology, in which traditional cooperatives and investor-oriented cooperatives are polar forms.

5.4.1. Proportional Investment Co-operatives (PICs)

Proportional investment co-operatives require cooperative members to contribute equity capital in proportion to usage through either one of the three main cooperative policies, the (i) base capital plans, (ii) narrowing product scopes and (iii) capital acquisitions on business unit basis. The base capital plan illustrates the simplest way in which the PICs operate. With the base capital plan, the cooperatives` capital requirements are determined first, based on future investment opportunities and members' willingness to supply risk capital. Secondly, proportional member usage is then determined by measuring the members' average usage over a base period and calculating the members minimum equity capital requirements based on relative patronage. With time, it is expected that some members could become over-invested and others under invested. Thus, it is important to design a plan to increase equity investment of under-invested members and redeem part of the equity for over-invested members (Chaddad & Cook, 2004). By allowing equity to transfer between over- and under-invested members, the internal free-rider problem is eliminated. However, the following weaknesses still exist;

- shares in a PIC cannot be traded (portfolio problem) at their market value (horizon and control problems)
- Voting rights are egalitarian (influence problem).
- PICs are complex to administer and oblige rather than encourage investment.

5.4.2. Member-investor Co-operatives (MICs)

Member-investor co-operatives give restricted voting, non transferable and redeemable ownership rights to member patrons but also allows other investors and member patrons to have non-voting shares that entitles them to the distribution of net earnings in proportion to member shareholdings rather than patronage. As a result, MICs separates patronage and investment thus allowing a substantial share of co-operative profits to accrue to member-investors rather than to member-patrons only. The MICs model can be implemented by means of either participation units, capital units or redeemable preference shares as evidenced in countries such as Netherlands, New Zealand and Australia

Participation units are non-transferable, redeemable, nonvoting and appreciable ownership rights. The board sets the value of participation units that will be issued for member patrons or member investors. Capital units enable cooperatives to raise additional risk capital and to provide investment returns to members. Capital units entitle the holder to an interest in the capital, but not in the members' share capital of the co-operative. Capital units are transferable, appreciate in value so that capital gains can be realised when the shares are redeemed. Redeemable preference shares are non-transferable, interest bearing, appreciable, non-voting and have redeemable ownership rights. These different types of shares fully address the free rider problem, however the following weaknesses still exist;

- The portfolio, horizon and control problems is not fully addressed because the tradability of these shares is reduced by uncertainty about capital gains since shares are redeemed at a price approved by the democratically elected board of directors not the market.
- The influence problem remains because shares held in a MIC do not grant voting rights in the co-operative

5.4.3. New generation co-operatives (NGCs)

New generation co-operatives (NGCs) were formed and quickly gained popularity in the US agricultural sector in the 1990s and in other countries including New Zealand. NGCs introduce the concept of well-defined property rights in the form of delivery rights (Cook, 1995). Delivery contracts set out members' rights and obligations to deliver products of a specified quality and quantity. Members must pay for any shortfalls on contacted delivery amounts or quality.

Member producers make sizeable capital investments to fund value-added processing facilities, with shares being linked to units of production. Member equity usually makes up 40 – 50% of capital, with the balance financed externally (Cook, 1995). Membership is closed, with shares tradable among members at share values that vary with the cooperative's prospects. New shares are sold if equity is required for expansion or in proportion to delivery volumes where equity is required for other purposes. Profits are distributed as patronage refunds, but since patronage and investment are proportional, this amounts to proportional dividends on invested capital. Non-voting securities can be sold to non-members also. New members have to purchase delivery rights from existing owners at their market price, thus enabling member-investors to realise capital gains.

Alignment of investment with capital gains and patronage returns addresses the internal free-rider problem. NGCs apply the one-member-one-vote principle, despite investments being proportional to patronage. Heterogeneity among members is reduced by NGCs operating in narrow business fields as compared to other agricultural cooperatives that often diversify. Directors are chosen from among members. NGCs resolve common traditional cooperative problems as follows;

- Horizon problems – removed by tradable shares
- Free-riding problems – are reduced since value of unallocated capital is reflected in tradable share prices, and investment/patronage signals are not distorted by artificially setting equity values as in traditional cooperatives;
- Portfolio problems – are minimal because NGCs' narrow business focus reduces conflicts over investment policy, members are fairly homogeneous and projects are thoroughly scrutinised before establishment.

However, the following weaknesses exist;

- Delivery rights do not fully address the horizon and control problems because members' shares remain non-tradable and therefore do not internalise or signal growth in NGC net worth when the proceeds of delivery rights issues are invested in growth assets.
- The competitiveness of the delivery rights market is questionable.
- Delivery rights have no effect on voting rights and therefore do not address the influence problem.

5.4.4 Cooperatives with capital seeking entities

This model addresses the restriction of cooperative ownership rights being restricted to member patrons by acquiring outside capital using a separate legal entity such as a strategic alliance, a trust company or a publicly held subsidiary. In the USA, some cooperatives form strategic alliances with another partner to acquire external risk equity capital. The deal could entitle the alliance to a share of profits or being a long-term supplier of inputs or expertise. As is the case with the Dairy farmers of America whose deal with a strategic alliance entitles the alliance to be the long-term preferred supplier in exchange of investing, marketing and processing the cooperative farmers' products. Alternatively, the cooperative can establish a non-operative entity, a trust company solely for acquiring risk capital from non-member sources, as is the case with Diamond cooperative owned by walnut growers in California, which established the Diamond Walnut Capital Trust. Finally, the cooperative could establish and transfer all its assets to a separate public limited company in order to receive risk capital from outside investors with new equity shares in the subsidiary company. This model has been used by Kerry Cooperative Creameries Ltd in Ireland, France by the cooperative bank Credit Agricole as well as in the USA by Gold Kisk, Agrilink and O`Lakes. However, the model has the following weaknesses;

- New organisational costs such as agency, collective decision making and influence costs are incurred. A cost benefit analysis is important to decide whether the model is beneficial or just an addition of costs.
- Control and horizon problems are still not fully addressed

5.4.5. Investor-share co-operatives (ISCs)

Neither the PICs nor NGCs accommodate equity and investment by non-members as they are restricted to member-patrons with the possible exception of MICs and cooperatives with capital seeking entities. ISCs acquire non member equity capital without converting to investor oriented firms by issuing separate classes of equity in addition to the traditional ownership rights held by patrons mainly preferred stock, non-voting common stock and participation certificates. Preferred stock is a non-voting, fixed dividend, non-redeemable ownership right. These have been issued in the USA by a Denver based cooperative bank, Cobank specialising in financial services for agribusiness and rural utilities. Non-voting common stock are a separate bundle of stock from the cooperative patron member non-transferable, non-appreciable and voting shares.

Investor-share co-operatives afford the cooperative an opportunity to raise permanent risk capital while maintaining member control. Thus, ISCs effectively publicly lists non-voting stock while maintaining voting stock in the hands of the cooperative members. ISCs are common among agricultural cooperatives in Australia (e.g. Australian Agric Co, AWB Ltd), Canada (Saskatchewan Wheat Pool even trades in the Toronto Stock Exchange). With participation certificates, outside investors may become members and invest in the cooperative. Farmer controlled businesses found in the UK exhibit the same model because farmers hold both control and the majority of shares with the primary goal of serving the economic interest of farmers. In summary, these shares alleviate the control problem, free rider, horizon and the portfolio problems. However, the following weaknesses exist;

- ISCs are argued to dilute the co-operative principles and thus may not qualify for all of the benefits and support afforded to conventional co-operatives e.g. South Africa's new Co-operatives Act does not allow development-oriented co-operatives to raise capital and expertise by taking on external equity partners

5.5. Alternative organisational changes

Hudson and Herndon (2000) state that successful cooperatives are far more likely to expand operations, merge with other cooperatives, or even to acquire companies before converting. The following section discusses some of the alternatives.

5.5.1 Mergers

A relatively large number of mergers have occurred in South African agribusinesses as is reported among U.S. agricultural cooperatives over the last ten years (Competition Commission (2004), Hudson & Herndon (2000) and Henehan (2002)). A merger is a combination of two or more companies into one larger company through either a stock swap or cash payment to the target company (Hudson and Herndon, 2002). Mergers usually result in a new company name. Various classifications of mergers (Wikipedia, 2008);

- Horizontal mergers take place when the two merging companies produce similar product in the same industry.
- Vertical mergers occur when two firms, each working at different stages in the production of the same good, combine.
- Conglomerate mergers take place when the two firms operate in different industries.
- Reverse merger is used as a way of going public without the expense and time required by a public corporation.
- Accretive mergers are those in which a company with a high price to earnings ratio (P/E) acquires one with a low P/E.
- Dilutive mergers are the opposite of above, whereby a company with a low P/E acquires one with a high P/E.

There are various reasons companies take part in mergers. However, in the end, mergers are usually directed to be beneficial to both parties taking part in the merger (Hudson & Herndon (2000) and Henehan (2002)). The underlying reasons for the failure of mergers have been shown to include the following among many reasons (Moeller, 2003);

- Incompatibility—whether of technology, equipment, or corporate culture.
- Inadequate research or by concealment of losses or liabilities by one of the partners.
- Overlapping subsidiaries or redundant staff may be allowed to continue creating inefficiency.
- New management may cut too many operations or personnel, losing expertise and disrupting employee culture.

Henehan (2002) indicates that several mergers have resulted in the formation of the largest dairy cooperatives in the U.S. Such is the case with some mergers that have occurred in South African agriculture (Competition commission, 2000). Due to such results, mergers are always viewed with much scepticism mainly because of concerns that they usually result in unfair or anti competitive behaviour such as the creation of monopolies or restriction of trade (Heykoop, 2003). Thus mergers have come under heavy analysis and regulation in most countries.

5.5.2 Acquisitions and takeovers

Acquisition and takeovers involve the buying of one company, the target company by another company (Hudson & Herndon, 2002). In most cases, target companies are usually smaller firms than the firm buying. Under normal circumstances, acquisitions are done in good spirit, with both companies cooperating and willing to take part in the acquisition deal. However, there are certain circumstances when the target company is unwilling to be bought or the target's board has no prior knowledge of the offer, this is usually referred to as hostile takeovers (Foltz, 2002). There are various types of acquisitions, chief of which are (Foltz, (2002) and Hudson & Herndon (2002));

- The buyer buys the shares, and therefore control of the target company being purchased. Ownership of the company in turn conveys effective control over the assets of the company, but since the company is acquired intact as a going business, this form of transaction carries with it all of the liabilities accrued by that business over its past and all of the risks that company faces in its commercial environment.
- The buyer buys the assets of the target company. The cash the target receives from the sell-off is paid back to its shareholders by dividend or through liquidation. This type of transaction leaves the target company as an empty shell, if the buyer buys out the entire assets. A buyer often structures the transaction as an asset purchase to pick the assets that it wants and leave out the assets and liabilities that it does not.
- Reverse takeover; Sometimes, however, a smaller firm will acquire management control of a larger or longer established company and keep its name for the combined entity.

5.5.3 Integration

Integration refers to the reorganisation of firms by either moving up the supply or value chain, or down the supply value chain. There are various motivations for integration but firms mainly use integration to increase their market shares, improve efficiency, build market power or to enter other new markets (Gregor (2003). There are basically three forms of integration, horizontal, vertical and backward integration.

- **Horizontal integration**; relates to the expansion of a firm at the same level in the value chain. The Competition Commission (2004) illustrates that a relatively large amount of horizontal integration has taken place in the maize supply chain. Some examples include OTK Agri/Farm Feed services, Afgri/Laeveld Korporatiewe

Beleggings, Afrigrain (Pty) Ltd/Unigrain Cape (Pty) Ltd, Afgri operations/Natal Agricultural Co-operative, Kaap Agri/ NLK e.t.c.

- **Vertical integration;** describes a situation where a firm has its interests diversified into related activities. It is basically a linkage between producers and distributors to final consumers. An example of vertically integrated companies in the South African maize market are the dominant silo companies (Mc Gregor, 2002). Examples in South Africa include Afgri/Nedan Oil Mills, Synapp international/Senwesko Voere, Rainbow Farms/Vector Logistics (Pty) Ltd, Afgri/Daybreak
- **Backward integration** into the production of inputs ensures stable supplies and reduces the cost of coordinating activities at different stages of production. This puts potential new entrants at a cost disadvantage and increases their sunk costs.

5.5.4 Joint ventures

A joint venture is an entity formed between two or more companies by combining their assets for a specific business purpose or to undertake economic activity together (Hudson and Herndon, 2002). The companies agree to create a new entity by both contributing equity, and they then share in the revenues, expenses, and control of the enterprise. Francois *et al* (2002) argue that unlike a merger, a joint venture typically involves only temporary, partial, and small activities. Thus the parent companies are still free to continue their activities separately. The idea is that in case a joint venture fails, the parent firms would be less affected.

5.6 The decision to convert

5.6.1 Various hypotheses

Schrader (1989) proposed that the nature of a patron's equity in terms of the method the cooperative uses to liquidate a member's equity results in cooperatives restructuring as investor-oriented firms, especially successful cooperatives. When cooperative members liquidate their equity and receive no more than its accounting book value, there is an economic motive for members to approve a sale or corporate reorganization such as converting to a company when the market value of the members' equity exceeds book value. Schrader (1989) states that if there is growth in the market value of assets due to inflation or other market forces, the liquidating value of a member's equity will eventually exceed its book value. Thus a sale or corporate reorganization of the cooperative will produce more value for members than liquidating their individual positions. Alternatively, Collins (1991) argues that the limited ability to generate internal equity in a cooperative especially when there is an opportunity for a profitable investment opportunity may create a rational choice to restructure the cooperative as a publicly held corporation with access to external equity.

The corporate acquisition hypothesis suggests that the motivation for the conversion of cooperatives may in some cases come from the corporate sector rather than from the cooperative (Collins, 1991a). The corporate acquisition hypothesis suggests that cooperatives may have sources of product supply and processing capacity that fit a corporation's plans for vertical integration. Alternatively, a corporation may wish to acquire a vertically integrated cooperative simply to expand its scale and spread the costs of central management functions. In other cases, a corporation may wish to acquire the cooperative's share of a finished product market. In addition, (Collins 1991a) argues that corporations may find cooperatives as easy prey for takeovers compared to taking over a comparable corporation because of the liquidation mechanism of cooperatives. For example, when a majority of the members of a cooperative have a short time horizon, the capitalized stream of benefits from cooperative membership will be small and any bid by a corporation in excess of the book value will be advantageous to these members.

The cost-of equity hypothesis suggests that contrary to the equity access hypothesis, access to cheap equity could be the main motivation to conversions. The cooperative could raise equity from economically rational members if the return expected by the member exceeded the opportunity cost of the funds (Collins (1991a, 1991b)). However, in cases when the income of the cooperative is highly correlated with the income of the members, the risk premium required by the member may exceed the premium required by a well-diversified external investor and external equity may therefore be cheaper to acquire than equity from members (Mooney & Gray, 2002). This would occur if the member is poorly diversified and the cooperative has low systematic risk for a broadly diversified portfolio. In this case, the equity of the cooperative would have high systematic risk for the member but low systematic risk for an outside investor, and a powerful incentive would exist for the cooperative to issue publicly held stock.

Harte (1995; 1997) based on transaction cost theory argues that efficient governance structures can be expected over time to replace inefficient structures in competitive markets. Harte (1997 states that as market performance improves and owing to the fact that cooperatives are perceived to be less efficient than corporations, it is expected that there will be a transition from the cooperative organisational form to the corporate form. Harte (1997 argues that cooperatives would be expected to persist indefinitely only in the case of chronic market failure. The basis of Harte`s (1997) explanation lies on the assumptions that cooperatives are less efficient than corporations and that cooperatives would be expected to persist indefinitely only in the case of chronic market failure.

Cook (1995) presents a five stage model of cooperative formation, growth and demise that seek to explain why and how cooperatives undertake restructuring activities based on transaction, agency costs and the property rights framework. Cook (1995) states that during stage one cooperatives are formed in a defensive nature thus creating incentives for collective action either when individual producers need institutional mechanisms to bring economic balance under their control or when they need institutional mechanisms to countervail opportunisms or market failure. During stage two, Cook (1995) indicates that cooperatives formed for economic balance or excess supply induced prices are usually short-lived and have little economic impact on their members. Whereas cooperatives formed to confront market failures survive the infant stage. When other competitors of successful cooperatives begin to modify their behaviour or strategies, members in a cooperative become aware of the problems intrinsic to the cooperative organisational form (mainly horizon, portfolio, control, free rider and influence costs problems) and the benefits that could be lost if the cooperative discontinues to operate. Thus the cooperative is faced with three options; (i) exit (ii) continue or (iii) transition. Cook (1995) states that under the exit option, the cooperative can either liquidate or restructure as an investor owned corporation. As a result, poorly performing cooperatives liquidate whereas well performing cooperatives restructure to companies, a trend similar to the developments of South African cooperatives (Ortmann & King, 2007a, b). Alternatively, the cooperative can continue operating and adopt modern cooperative models or take the transition option by converting to new generation cooperatives popular in the USA or other modern cooperative models.

5.6.2 Company versus the cooperative business model.

5.6.2.1 Market orientation

Kyriakopoulos *et al* (2004) state that market orientation consists of (i) competitor orientation, which includes the activities involved in acquiring information about the competitors in the target market and transmitting it throughout the firm, (ii) customer orientation, which includes the activities involved in acquiring information about the customers in the target market and disseminating it throughout the firm, and (iii) inter-functional coordination, which comprises the firm's coordinated efforts, involving more than the marketing department, to create superior value for the customers. Kyriakopoulos *et al* (2004) show strong evidence that market orientation is a key strategy that firm's adopt to build a long-term competitive position because it increases customer satisfaction, customer loyalty and new product success. Thus, it is argued that companies, whose key to survival is their competitive advantage, tend to be more market oriented than cooperatives (Kyriakopoulos *et al*, 2004). Cooperative principles and their essence are argued to limit the extent to which they can be market oriented as compared to a company. However, despite the strong argument of companies being more market oriented than cooperatives, Piesse *et al* (2004) indicate that grain cooperatives are also changing from being member oriented to being market oriented by gaining market power and adopting market oriented strategies.

5.6.2.2. Ownership

In a traditional cooperative, ownership is restricted to those who patronise the organisation and new members often pay only a nominal sum for the equity. This is different in modern cooperative models as discussed in section 5.4 which have adopted innovative ownership structures. However, when based on traditional cooperative ownership structures whereby equity ownership is tied to a normal membership fee and the distribution of profits is in proportion to patronage, the ownership claim of a cooperative shareholder differs in several ways from that of a company whose equity ownership is tied to the level of capital invested and there is a secondary market for company shares. Such arrangements make company shares more attractive and have possibilities of a higher return as compared to cooperative shares. This is compounded by the fact that in traditional cooperatives, member's shares are redeemed at the nominal value of their member nominal investment upon exit. Thus the amount paid on such redemption does not reflect the current market value of cooperative membership, or the present value of expected future cooperative net cash flows. However, as was discussed in section 5.4 some new cooperative models have established an internal secondary market for member shares and allowed for appreciable investments or shares.

5.6.2.3. Control

Democratic control of cooperatives in the form of one member one vote, results in different control issues and behaviour of cooperatives when compared to companies whose voting is based on the member's shareholding. The one member one vote principle creates no incentive for members who may be willing to contribute large capital as that does not imply that they influence cooperative decisions in order to protect their investments. As such, it is expected that coalition building among members is much more important in the decision making process of cooperatives than in that of companies. Thus, cooperatives that delegate greater decision making authority to management may be better able to compete with companies, albeit at the cost of less direct member involvement in decision making. Usually, cooperative boards restrict non members from serving on the board of directors. The advantage to this is that because members of the board are users of the cooperatives` services, they may bring to the board some of the technical knowledge about the cooperatives services and operations that outside directors may lack. If the cooperative's operations are complex or extend far beyond the farm, however, it is likely that member directors will lack the expertise in marketing, manufacturing, or retailing that external directors could provide.

5.6.2.4 Managerial behaviour

The lack of a secondary market for cooperative shares denies the cooperative tools for influencing managerial behaviour (Suhler & Cook, 1993). Cooperative shareholders have no simple indicator like a share price by which they can evaluate how well management has enhanced the future earnings capacity of their firm. If they evaluate management primarily on the current prices the cooperative charges for its services, the manager may be induced to de-capitalize the firm in an attempt to increase current earnings, simply reinforcing the horizon problem. Fluctuations in the value of company shares therefore serve as an important disciplining mechanism on management. Many firms reinforce the strength of this disciplining mechanism by offering share options to top management, which makes the earnings of these personnel based on the share value. Tying the manager's earnings to the firm's performance, as judged by the share market, may thus reduce managerial shirking (Alchian & Demsetz, 1972).

Staaz (1987) argues that in most cases cooperatives members tend to pressure management to adopt more conservative business strategies than those of competing companies because investments in cooperatives are largely sunk whereas owners of a company can sell their shares and quit the organisation if they believe the investment is not worth it. Furthermore, because of the immobility of cooperative capital, it is more difficult for cooperatives than for companies to spread their risks by diversifying into totally unrelated activities. Finally, Kyriakopoulos *et al* (2004) indicates that cooperative managers, particularly those of large, diversified cooperatives may spend more time on member relations, thus putting cooperatives at a competitive disadvantage because their chief executive officers have less time than company managers for strategic planning and administration.

5.6.2.5 Scope for optimization

Staaz (1987) states that the scope for optimization in a cooperative is potentially broader than in a competing company that is not vertically integrated into farming. This is because a profit-maximizing farmer-member would be interested not in running the farm and the cooperative as separate profit centres but in optimizing the performance of the integrated farm/cooperative system (Staaz, 1987). Firstly, the scope for optimization is more diffuse because cooperative returns are distributed according to patronage, not investment. As a result, the cooperative does not have one locus for profit maximization but a separate locus for each member. Secondly, cooperatives tend to give greater weight to their patrons' fixed costs than companies. For example, an agricultural processing cooperative will more likely give greater emphasis to providing its supplier-members a market for their product than will a company because the cooperative takes into account of the need of its members to pay back their fixed on-farm production investments. Comparatively, a company usually does not have to deal directly with its suppliers' fixed costs, they are transformed via the market into the raw-product price that the company pays and considered as purely a variable cost (Staaz, 1987). As a result, the capital of cooperatives tends to be less mobile than that of other business models as they concentrate their investments in agribusiness activities closely related to the farming activities of the members because the members might suffer substantial capital losses if their farming activities were not adequately supported. These capital losses would not affect the income of shareholders of a company serving these farmers. Hence, there would be little pressure on company management to invest in these agribusiness activities if more profitable opportunities lay elsewhere.

5.6.2.6. Pricing behaviour

The pricing behaviour of a cooperative directly affects the income of the members as opposed to companies whereby the income that shareholders derive from a company depend on the firm's profitability through dividends (Kyriakopoulos *et al*, 2004). As a result, cooperative members using their influence as owners demand to be involved in pricing decisions. But because of the diversity of member`s interests it may be difficult to reach a consensus about what the appropriate pricing and cost-allocation rules should be. The result is that the price setting is likely to be a more costly process in cooperatives than in companies where management often makes pricing decisions with no shareholder input. Thus, a cooperative's ability to cut prices and offer subsidies in order to gain market share may be much more restricted than in companies. As a result, cooperatives may be less able than companies to enter new fields where gaining market share requires initial price-cutting. However, contrary to the above arguments, Evan and Meade (2006) indicate that the pricing behaviour of cooperatives were the same as that of investor oriented firms.

5.6.2.7 The structure of incentives facing individual stakeholders

In order for both the cooperatives and company to be successful they have to coordinate their operations with those of the stakeholder’s interests. Hind (1994) shows that the interest of the membership of a cooperative as a whole usually does not correspond with that of individual members. This is usually the case if incentives exist for cooperative members to operate their farms in a totally independent manner or when the cooperative has a highly heterogeneous membership which can make it difficult to get members to agree on anything other than running the cooperative as a separate profit centre. Such dilemmas’ or problems of collective choice are rare in companies whose incentives to participate in the firm is to maximise shareholder value or profits.

The differences in equity and how equity is treated by cooperative and company are different. The fact that equity capital does not appreciate in a cooperative may reduce the incentive to found a cooperative even when the social benefits of doing so exceed the social cost (Shaffer, 1982). In the case that the cooperative is started and substantially improves the profitability of the founders' farm enterprises, there is the issue of free rider problem, horizon problem and portfolio problem to be dealt (Chaddad and Cook, 2004). On the contrary, entrepreneurs who found a successful company are rewarded with substantial capital gains as the net worth of the firm increases. Attracting new cooperative members may be difficult because of geographic limits on the cooperative's scope of operations and because, in certain cooperatives, only farmers engaged in particular types of production are admissible as members (Mooney and Gray, 2002). In comparison, geographic limitations do not apply to ownership and membership in a company.

CHAPTER SIX
COMPARATIVE DYNAMISM OF COOPERATIVES AND COMPANIES

6. 1 Introduction

This chapter presents the results from the questionnaire survey investigating the dynamism of cooperatives and companies. Dynamism is compared based on four broad factors, which are (i) changes in adopting property rights, (ii) organisational strategies (iii) organisational culture and (iv) management. Of importance is that this chapter discusses recent trends and developments as well as the diversity in dynamism that both agribusinesses companies and cooperatives are adopting.

6.2. Comparative dynamism of cooperatives and companies

6.2.1. Organisational strategies

Table 4 indicates that companies take corporate social investment more seriously, especially in as far as education is concerned. All the companies indicated that they played a direct role in corporate social investment by being involved in supporting schools and students through bursaries and donations. This is a clear form of social responsibility with a social dimension in a competitive context as explained by Porter and Kramer (2006), thus indicating the drive for agribusiness companies to engage in social responsibility if it will pay off for them in the future. Comparatively, cooperatives played an indirect role in corporate social responsibility through their subsidiaries. The difference is that cooperatives are more focused on generic social issues such as community development. Despite their limited role in education and training programmes cooperatives indicated that they are struggling to retain or recruit the right calibre of employees.

Table 4: The role agribusinesses play in social responsibility

Agribusiness	**Social responsibility**
Comp A	Offers trainee programmes
Comp B	Sponsor student and donate to schools and child welfare institutions
Comp C	Focus on educational (Schools) and agriculture initiatives
Comp D	In the process of sponsoring a student
Coop A	Subsidiary supports a school for the blind
Coop B	Subsidiary supports community development
Coop C	None

Despite the importance of environmental sustainability or eco sensitive initiatives all the agribusinesses never adopted any environmental sustainability or eco sensitive initiatives except for two companies. Company A practised sustainable agricultural practises whereas company D adopted the initiatives in its fuel outlets because of mandated requirements from the EIA. The growing importance of social and environmental responsibility, has led to the adoption of triple bottom line accounting in order to account for firms` role in social and environmental responsibility (Savitz & Weber, 2006). Dynamic businesses firms use triple bottom line accounting when presenting their annual reports. Only one of the agribusinesses companies use triple bottom line accounting reporting comprehensively. The rest of the agribusinesses mainly report their financial and social responsibilities to a limited extent.

Black Economic Empowerment (BEE) is one of the most important and critical transformations occurring in South Africa. Even though businesses have until 2014 to become BEE compliant, the implications and impacts of BEE are already being felt especially in the allocation of certain contracts or tenders. BEE is measured in scorecard ratings, 40 points or less represents non BEE compliant, 41 to 65 points represents good contributors and a score of 66 plus represents excellent contributors (DTI, 2007). A business needs at least 40 points to be BEE compliant. Table 5 shows that only one of the agribusiness companies was BEE compliant, with a score of 50%, the rest scored less than 40%. This confirms concerns about the relatively slow pace of BEE compliance in agriculture and agribusinesses. The areas where agribusinesses have made significant advancements are in employment management and corporate social responsibility. However, to increase the BEE scores, agribusinesses need to work on business ownership, skills development, preferential procurement, enterprise development and employment equity.

Table 5: The BEE scores

Agribusiness	**BEE SCORE CARD**
Comp A	Less than 40%
Comp B	Less than 40%
Comp C	50%
Comp D	Less than 40%
Coop A	Less than 40%
Coop B	Less than 40%
Coop C	Less than 40%

All the agribusinesses interviewed acknowledged that competition in the industry were strong, necessitating the need for various investments and structural changes in order to be competitive. Horizontal integration appears to be the most widely adopted integration strategy by both companies and cooperatives as shown in Table 6. Only one company was involved in vertical integration and no agribusiness was involved in backward integration. This is mainly because of the advantages horizontal integration has on improving the competitive position of the company and reducing transaction costs on the same value chain whereas vertical integration serves more as a risk management strategy which can also be addressed by diversification as evident from the fact that agribusinesses that undertook horizontal integration also had diversified investments. Company A which did not diversify undertook vertical integration. The highly dynamic firms are more likely to have invested in the money market or outside agriculture, as was the case for company D, whereas, company C, company D and cooperative A made investments outside agriculture. Table 6 shows that all cooperatives and agribusiness companies have all taken part in mergers, joint ventures and strategic alliances. Indicating a trend to building more networked organisations. These changes and investments have been motivated by management for both cooperatives and companies, contrary to the belief that members in cooperatives are the ones who push for such actions. However, it should be noted that management in a cooperative could hugely be made up of members.

Table 6: Restructuring actions undertaken by the agribusinesses

	Comp A	Comp B	Comp C	Comp D	Coop A	Coop B	Coop C
Vertical integration	✓			✓			
Horizontal integration	✓	✓	✓	✓	✓	✓	✓
Diversification		✓	✓	✓	✓	✓	
Invested in the money market				✓			
Invested outside agriculture			✓	✓	✓	✓	
Mergers	✓			✓	✓	✓	✓
Joint ventures	✓	✓		✓	✓	✓	✓
Strategic alliances	✓	✓		✓	✓	✓	
Conversion to company		✓	✓				
acquisitions	✓		✓			✓	

All the agribusinesses in the study have undergone significant changes in their product mix or services and have added value to the products they handled before, mainly as a response to the changing consumer profile, tastes, to improve competitiveness and to gain markets. Table 7 shows that two companies (B and D) have had significant changes to their clients whilst companies A and C haven't had changes to their customers over the past 5 years. Companies A and C converted from cooperatives to companies in 1998, whereas companies B and D converted recently, thus it is expected that the recent structural changes came with changes to customers and clients. Cooperatives still retain more or less the same customers or clients as they had five more years back. In addition, cooperatives distinguish between member and non members as clients by offering discounts to their members, thus offering an incentive to be a cooperative member, whereas companies do not distinguish between members and non members as clients. Both companies and cooperatives assisted their member clients to enhance their efficiency or profitability because it created value for the firm.

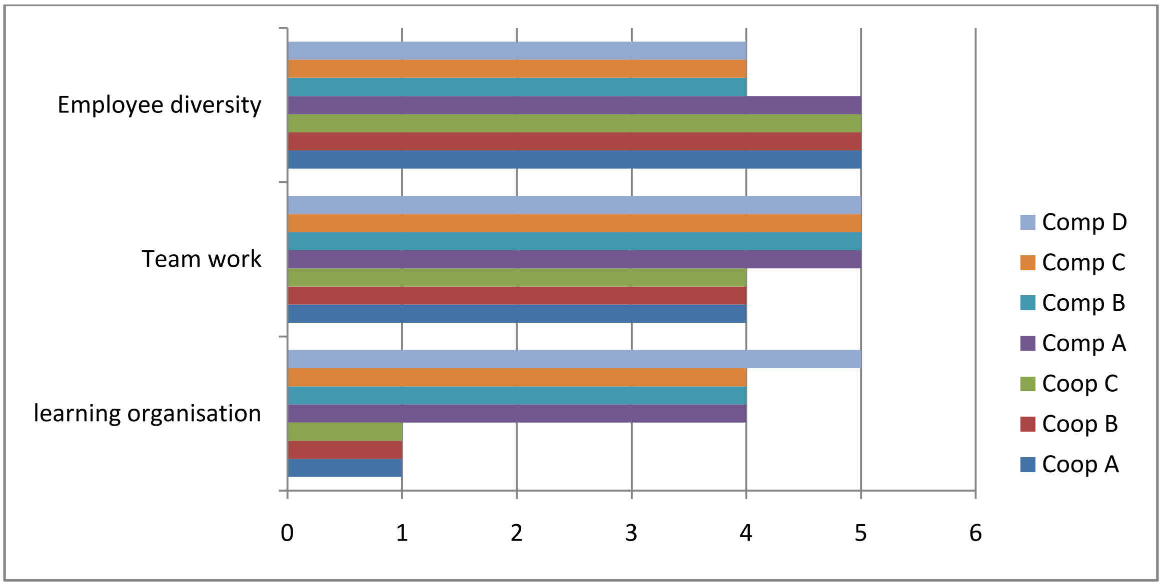
Table 7: Changes in customers or clients

	Comp A	Comp B	Comp C	Comp D	Coop A	Coop B	Coop C
No change	✓		✓				
Slight changes					✓	✓	✓
Significant changes		✓		✓			

6.2.2 Organisational culture and structure

Establishing the correct and appropriate organisation culture is an essential process of managing an organization (Schermerhorn *et al*, 2005). Figure 4 below shows how the different firms rated the following characteristics from a scale of 0 to 5, with 0 indicating that the specific characteristic does not exist whereas 5 indicates a strong presence of the characteristic. The results indicate that companies have a constructive culture which is much more dynamic than that of cooperatives. Team work and being a learning organisation is characteristic of companies, cooperatives also exhibits such characteristics though at a slightly lower scale. Even though diversity in employees is considered highly important by both cooperatives and companies, there is a consensus that recruitment is inhibited by the availability of suitable candidates and the negative view the job market has on agriculture, as well as the rural location of the agribusinesses.

Figure 4: Differences in organisational culture



When the organisational culture of the agribusinesses are mapped using the approach developed by Schermerhorn *et al* (2005), cooperatives and companies show a hybrid of the constructive cultures and aggressive/ defensive cultures as shown in Figure 5.

Figure 5: The organisational culture of the agribusinesses

MOST EFFECTIVE

Passive/ Defensive Cultures	**Constructive cultures**	**Aggressive/ Defensive cultures**
Members are defensive in their actions • Approval • Conventional • Dependant • Avoidance	*Members are helpful in their interactions* • Achievement • Self actualising • **Learning organization** • **transformational** • Affiliative • **Employee diversity** • **Team work** • Work with greater motivation • **Dynamic** • **Informal and relaxed**	*Members are forceful in their interactions* • **Emphasis of Power** • **Competitive** • Perfectionist • Oppositional

HYBRID

All the agribusinesses have undergone some form of changes in their organisational structure in the past 5 years. This highlights the importance of adapting organisational structures to suit the environment. Figure 6 show that cooperatives have a hierarchal structure as compared to companies. Secondly, both cooperatives and agribusinesses are becoming more networked organisations. Cooperatives indicate that they have acquired a company or some business unit under their group name as compared to companies who state that they haven't done the same, with the exception of one company. However, analysis of company annual reports presents a different story because they indicate that companies do own one or more companies under their group name. Both cooperatives and companies seem to strongly agree that they have established independent companies or business units. These observations indicate that the organisational structures of agribusinesses is becoming more networked.

Figure 6: The changes in organisational structure

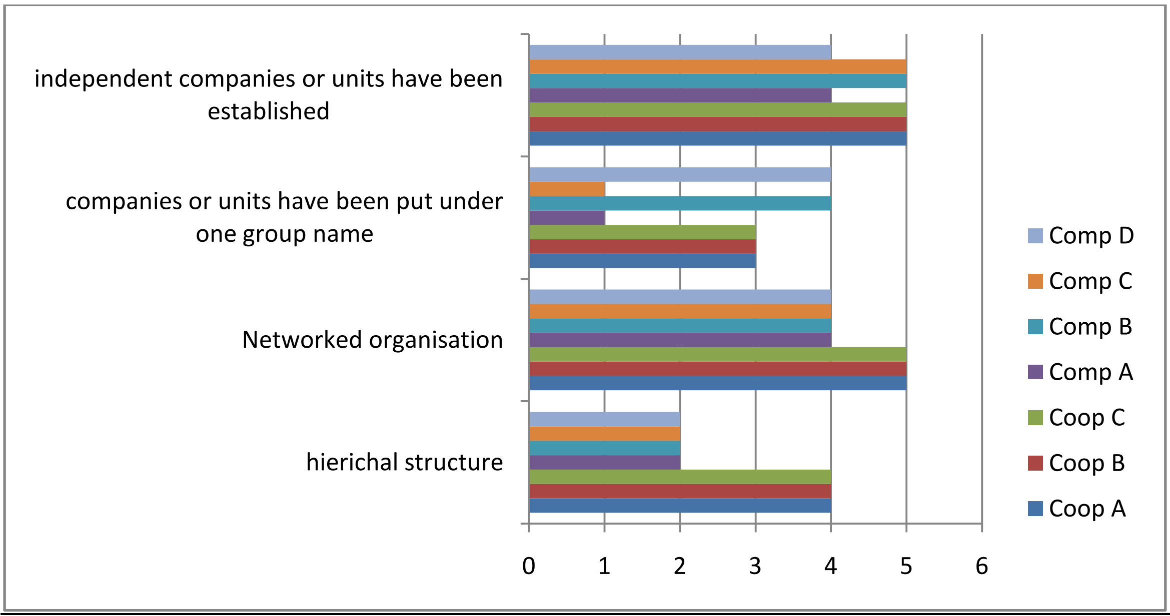


Figure 7 shows the old traditional organisational structure of most cooperatives. There has been a transition to a more networked organisational structure by cooperatives and companies as shown in Figure 8. Most units, subsidiaries and investments have been placed under one group name. Thus the question of who owns who and what is becoming relatively important for agribusinesses. Business empires are becoming the norm, with much emphasis becoming increasingly drawn to size and power. However, the changing organisational structures also confirm the nature and types of investments the agribusinesses have had to undertake in response to the dynamic business environment.

Figure 7: Traditional organisation structure of cooperatives

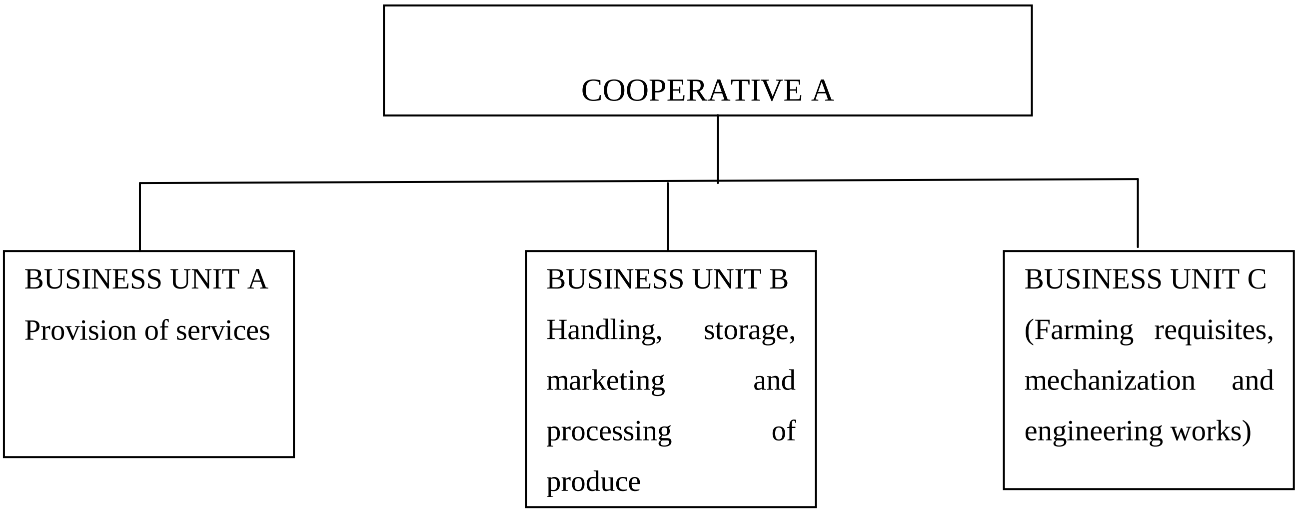
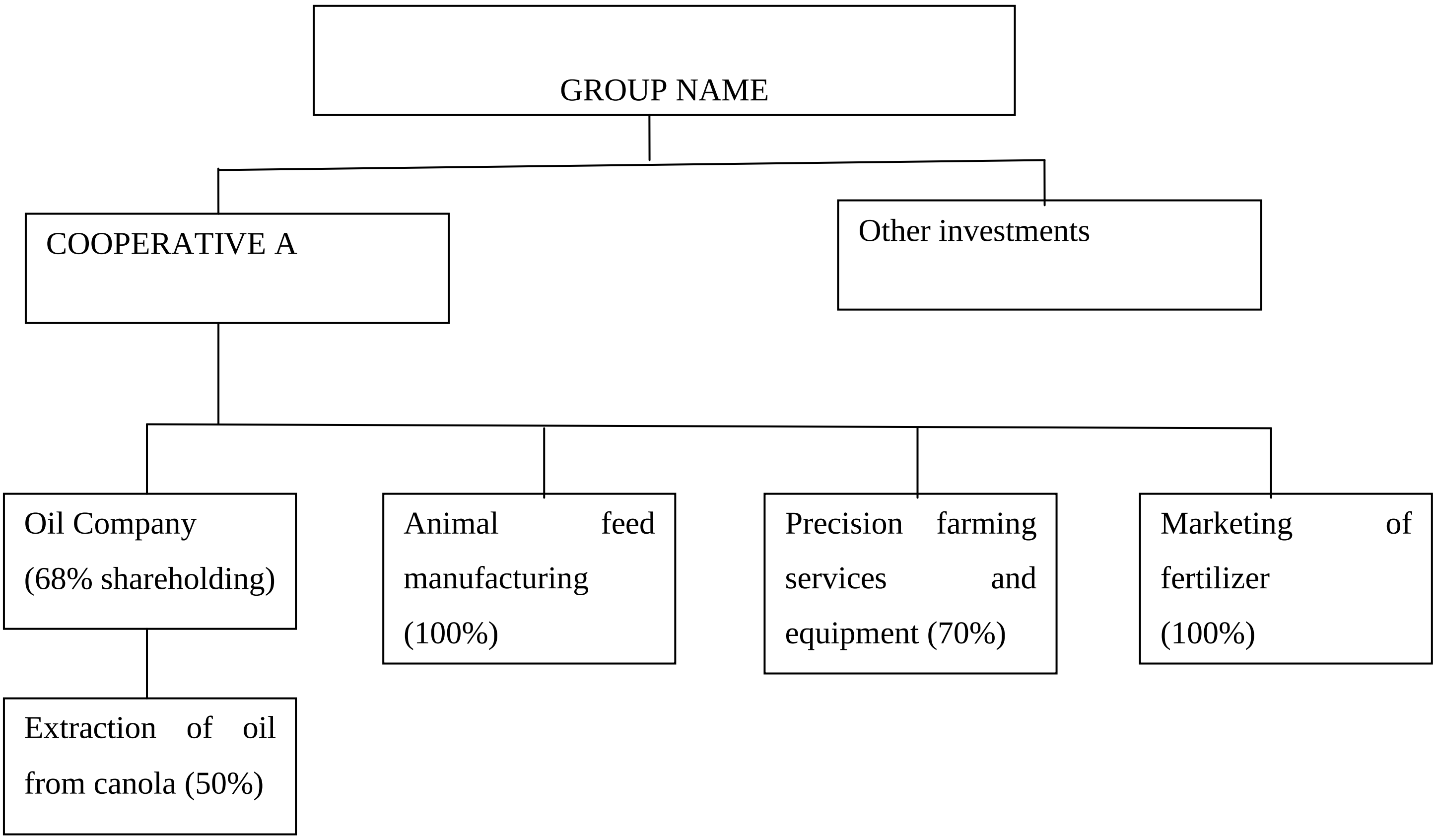


Figure 8: The organisation structure of modern cooperatives



6.2.3 Management

Table 8 shows that the management styles of both cooperatives and companies reflected a trend that is dynamic, informal, relaxed and focused on transforming people. In addition, all the agribusinesses acknowledged to have changed their management styles to suit the new environment which is critical given the dynamic environment.

Table 8: Management styles

	Comp A	Comp B	Comp C	Comp D	Coop A	Coop B	Coop C
Dynamic	✓		✓	✓	✓	✓	
Informal and relaxed	✓	✓	✓	✓	✓	✓	✓
Formal							
Focused on transforming people			✓	✓			
Changed their management styles to suit the new environment	✓	✓	✓	✓	✓	✓	✓
Heterogeneous				✓			
Homogeneous	✓						

Management incentives and compensation has been shown to have a strong link with performance and thus organisational performance (Demsetz, 1983). As expected all the agribusiness companies offered benefits and incentives to management in order to enhance performance. Table 9 shows that the most common incentive to all the agribusinesses was the profit share and incentive bonus. However, one of the companies also offered honorary rewards or non financial recognition, a clear indication of a strong culture of high performance in the organisation. Thus, it comes as no surprise that the rate of staff turnover (management) is low for all the agribusinesses.

Table 9: Management incentive schemes

	Comp A	Comp B	Comp C	Comp D	Coop A	Coop B	Coop C
share option	✓	✓	✓	✓			
profit sharing	✓		✓		✓	✓	✓
incentive bonus	✓	✓		✓	✓	✓	
honorary rewards or non financial recognition		✓					

6.2.4 Property rights

Today's challenging environment requires organizations to have well defined and structured property rights in order to be successful. The cooperatives interviewed showed the same property rights framework that has come under criticism and has led to the emergence of new cooperative models in other countries. The following summarise the property rights that emerge from the cooperatives;

- No different classes of shares have been established to accommodate new investors
- Shares are traded through private sells and do not fluctuate in value
- Members still redeem their equity or shares at nominal value if they want to exit the organisation
- Do not allow non patron investors in the organisation
- There is still use of the one member one vote principle

However, all the cooperatives indicated that the continued use of somewhat ill defined property rights was mainly because of the Cooperatives Act 2005 (Act 14 of 2005) that prohibits or limits the cooperatives to adopt well defined property rights as has been the case in other developed countries. The following were cited as the major constraints of the cooperatives Act 2005 (Act 14 of 2005);

- **Membership**: the act restricts membership of cooperatives to natural persons only. Thus this provision is challenging or unclear especially for established cooperatives who are continually seeking membership from high net worth clients such as trust companies.
- **Voting principle:** section 3(1) b and 14(1)(e) states that in the case of a primary co-operative, each member has only one vote. Thus even if cooperatives were to adopt innovative voting systems, it would be against the act. In addition, the act strictly prohibits a weighted voting system based on shareholding or participation in the cooperative. Section 3(3) however indicates that the constitution of a secondary or tertiary co-operative may provide that the members have more than one vote: Provided that in the case of a secondary co-operative no member shall have more than fifteen per cent of the vote of all the members of the co-operative. Thus this is a constraint when compared to the company business model where share participation is unlimited (unless limited by the company articles).
- **Shares**; section 41 (4) states that all shares issued must be of the same class and ranking thus making it difficult for cooperatives to create other innovative shares in order to cater for different investors needs. In addition, 41 (6) indicates that transfer of

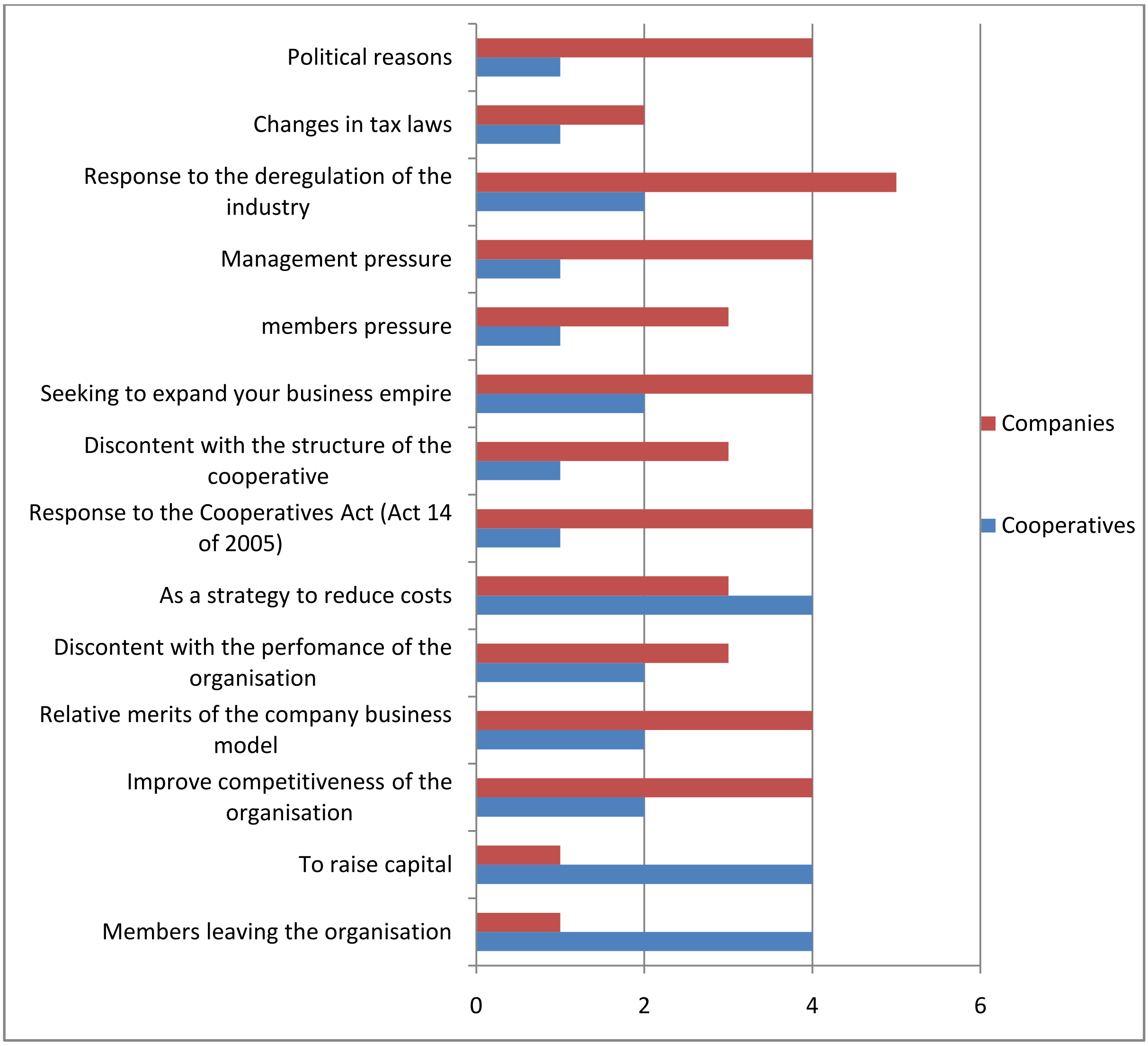
membership shares is only valid if it complies with section 25, that gives a lot of power to the cooperative as they can defer such payment for a period not exceeding two years if the payment would adversely affect the cooperatives financial well-being.

All the agribusinesses had the advantage of having enough capital to finance their major investments because they could acquire loans or credit easily due to their balance sheet. As expected, cooperatives still have members patronising the organisation as the majority of shareholders. The trend is similar in companies, the main investors are members or those involved with the organisation in one way or another, even though institutional investors like trust companies are stakeholders in companies, they are not the major shareholders. Figure 9 shows that cooperatives seem to favour bank loans and reserved funds whereas companies seem to have a wider choice in sources for finance. All the cooperatives and companies had a conservative dividend policy in as far as declaring dividends were concerned whereas companies indicated in having an aggressive dividend policy in as far as investing is concerned. This indicates the relative importance of investments and the long term view companies have as compared to cooperatives whose long term view may be influenced by the horizon period of individual members.

6.3 Motivations and reasons for structural changes

The main reasons cooperatives state for undergoing structural changes is to raise capital, as a strategy to reduce costs and because of members leaving. Companies indicate that they have had to undergo structural changes (conversions included) mainly for political reasons, as a response to the deregulation of the industry, management pressure, seeking to expand the organization, response to the cooperatives act, relative merits of the company business model and seeking to improve competitiveness. The deregulation of the industry is cited as the major reason for structural changes by both cooperatives and companies, which shows the pressure competition exerts on businesses and the need to improve competitiveness in the dynamic environment. However, one inconsistent observation is that companies indicated that they have had to make structural changes in response to the cooperative act (act 14 of 2005) even though they converted to companies in 1998 and were thus unaffected by the new act then. Figure 9 shows other reasons given for structural and their ratings on a scale of 0 to 5.

Figure 9: Reasons for structural changes



6.4 Results of the dynamism score card

Table 10 shows that companies are by far much more dynamic than cooperatives. The average dynamism score for companies is 83.75 as compared to the score of 62.33 for cooperatives. Cooperatives compare favourably well in all the dynamism factors except for their property rights framework, which is the main differential factor. Cooperatives are definitely not dynamic in terms of their property rights mainly because of the limitations of the Cooperatives Act (Act 14 of 2005). All the agribusinesses still have to improve their role in environmental sustainability or eco sensitive initiatives, role in BEE as well as in adopting the triple bottom line accounting reporting method. Thus contrary to intuition and expectations, cooperatives are showing that they are as and have the potential to be more dynamic than companies if their property rights structures are addressed. More specifically if the Cooperatives Act (Act 14 of 2005) accommodates some issues that are constraining cooperative dynamism.

Table 10: Results of the dynamism score card

		COOPERATIVE				COMPANY		
Specific criteria of comparing dynamism	**Max Score**	**A**	**B**	**C**	**A**	**B**	**C**	**D**
Role in corporate social investment	3	1	1	2	3	3	3	3
Environmental sustainability or eco sensitive initiatives	3						3	3
Nature of investments	5	5	4	3	5	4	4	5
BEE score card	3	1	1	1	1	1	3	1
Accounting reporting method	3	1	1	1	1	3	1	1
Changes in customers	4	2	2	2	4	2	4	2
Changes in product mix or services and value addition	4	4	4	4	4	4	4	4
Management style	10	10	8	9	9	9	10	8
Management incentives and compensation	15	10	10	10	10	10	10	10
Organisational culture	10	8	6	9	9	8	9	8
Structure of the organisation	5	4	3	4	4	4	4	4
Restructuring actions in the past 5 years?	5	5	4	5	5	5	5	5
Type of investors	5	3	3	3	5	5	4	4
Shares (price, how they are redeemed, classes)	10	4	4	5	10	8	10	10
Dividend policy	5	4	4	4	5	4	5	5
Voting principle	5	2	2	2	5	5	5	5
Capital structure	5	4	4	4	5	5	5	4
DYNAMISM SCORE		**68**	**61**	**68**	**85**	**80**	**88**	**82**
TOTAL DYNAMISM SCORE (Average)	**100**	**62.33**			**83.75**			

6.5 Summary

- Changes that are occurring in both cooperatives and companies confirm the increasing importance of dynamism in order to survive and lead in the ever changing business environment.
- Contrary to prior expectations, cooperatives show that they are also embracing change because they have adopted new organisation strategies, structures and culture. Cooperative management also shows a great deal of dynamism that is closely comparable to companies.
- However, the property rights of cooperatives are still the same with that of the much criticised traditional cooperatives. Thus their overall dynamism score is lower than

that of companies (62.33 as compared to 83.75). Cooperatives point at the difficulty to adhere to the Cooperatives Act (Act 14 of 2005) and its limitations to changing the property rights of the cooperatives. Such limitations have meant that it is difficult or almost impossible for commercial cooperatives to adhere to such policy thus the choice to converting to companies. As a result, if amendments are not made to the cooperative act, there is expectation of a continual decrease in the number of commercial cooperatives, with the rise of development or emerging cooperatives which are heavily supported by the new cooperative act and other supporting policies?

- On the contrary, companies seem to be more dynamic and embracing change even though they still have to improve their role in environmental sustainability or eco sensitive initiatives, role in BEE as well as in adopting the triple bottom line accounting reporting method in order to be fully dynamic, challenges also shared by cooperatives.

CHAPTER SEVEN
COMPARATIVE FINANCIAL PERFOMANCE OF COOPERATIVES AND COMPANIES

7.1 Introduction

The objective in this chapter is to present the financial analysis of the agribusiness companies and cooperatives using financial ratios obtained or calculated from income statements and balance sheets as supplied by CIPRO. The relative performance of cooperatives to companies is compared across different financial ratios mainly, (i) profit margin, (ii) return on assets (R.O.A), (iii) return on equity (R.O.E)**,** (iv) current ratio**, (**v) debt to asset ratio, (vi) asset turnover ratio, (vii) asset growth**, (**viii) revenue growth, and (ix) economic value added. However, it is important to note that because of the small sample size, there will be a tendency to underscore cooperative performance. On each financial ratio, the chapter first discusses the relative performance of agribusiness companies (A & B) that were formed by mergers by comparing them to their merger partners' in order to investigate the impact of such mergers. Of importance, an industry benchmark as set by Price Waterhouse and Coopers is also used to indicate on average how the firms are performing as compared to the industry as a whole.

7.2 Financial accounting analysis

7.2.1 Profit margin

The profit margin measures how much out of every rand of sales a company actually keeps in earnings. Because profit margin illustrates the profit a company makes after paying off its costs, a higher profit margin indicates a more profitable company that has better control over its costs compared to its competitors. Gitman (2000) also indicates that profit margin illustrates how efficient the management is in using its labour and raw materials in the production process. Firms that have a high profit margin (over a period of at least 5 years) show that they can keep their costs under control, are more liquid and thus have more cash to spend on research and development expenses, marketing or investing.

Figure 10 indicates that after the merger in 2004, Company A`s profit margin increased or was higher than that of the merging partners (data for the other merging partner was unavailable). On the contrary, Figure 11 shows that after the merger and its formation, Company B had a lower profit margin than one of the merging partners. Results in Figure 10 and Figure 11 suggest that one of the merger partners is likely to be more successful than the other merging partner. Thus, due to inadequate data, it is inconclusive as whether mergers resulted in an overall improved profit margin for the company.

Figure 10: The profit margin of company A and its merging partner

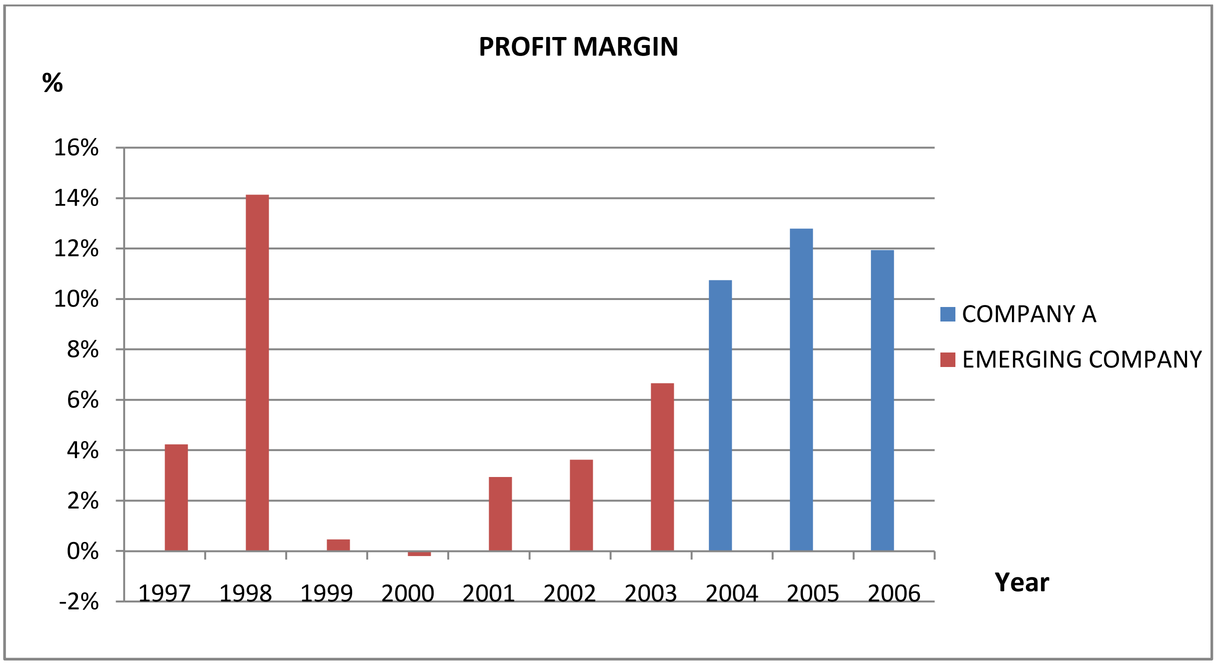
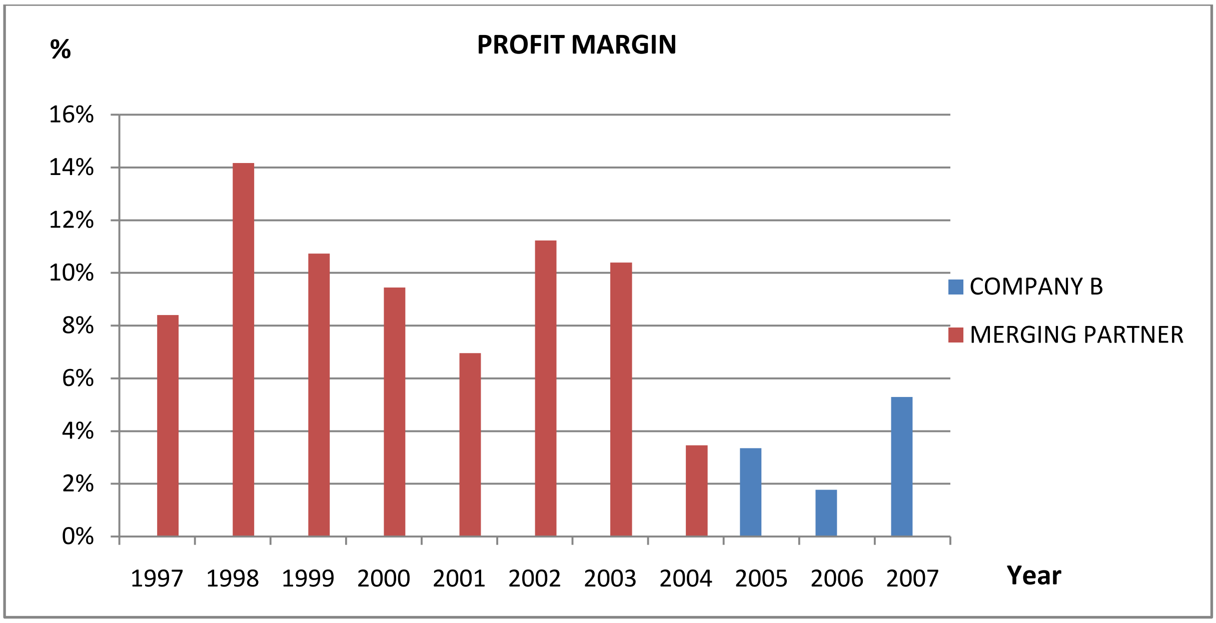
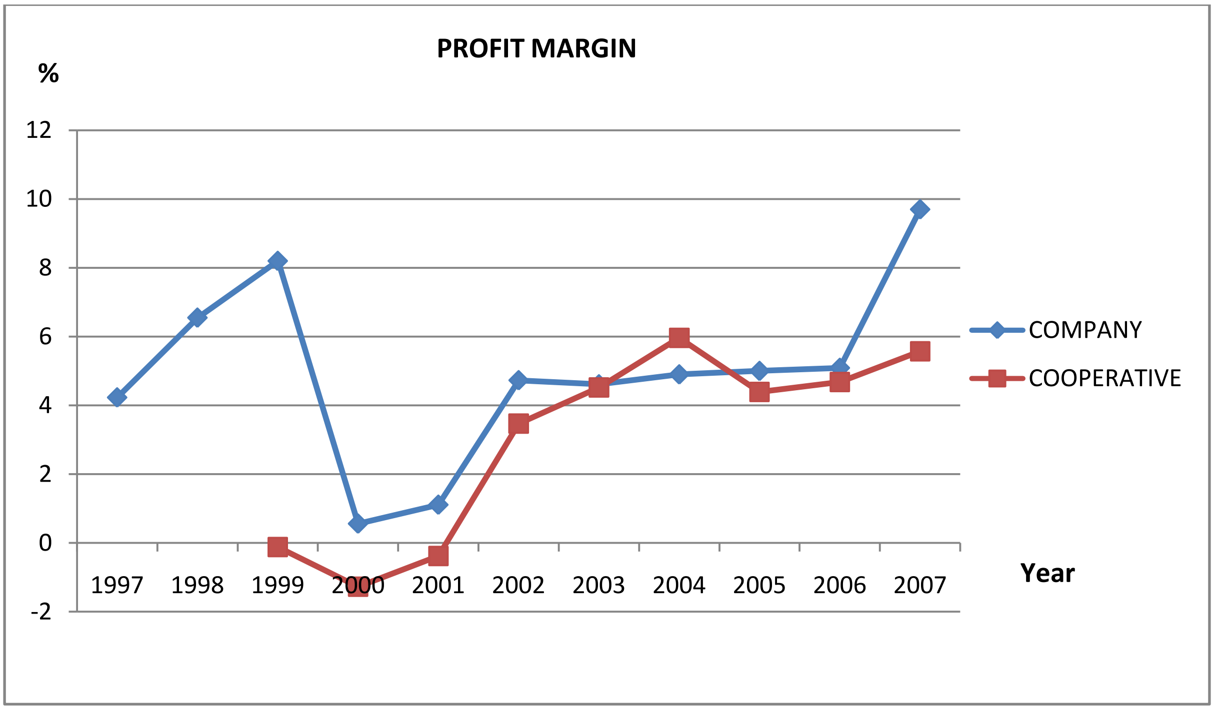


Figure 11: The profit margin of company B and its merging partner



The expectation is that companies have higher profit margins than cooperatives because of their profit motive. Figure 12 confirms this expectation as companies had a relatively higher profit margin than cooperatives (albeit a small difference) for most years except from 2003 to 2005 when cooperatives show a higher profit margin. Thus from the year 2000 to 2006 the differences in profit margins is relatively small, but is significantly higher in the years 1999, 2006 and 2007. The PWC benchmarking survey indicates that the industry standard for profit margin is about 7.4% and 6.8% (2006 and 2007 respectively). Figure 12 shows that agribusiness companies under review managed to report a higher profit margin than the industry benchmark for 2007, whereas cooperatives have failed to surpass this industry benchmark for both 2006 and 2007.

Figure 12: The profit margin of cooperatives and companies



7.2.2. Return on assets (R.O.A)

Return on assets (R.O.A) indicates the profitability per rand of assets by measuring the firms` overall effectiveness in generating profits with its available assets. R.O.A gives an idea as to how efficient management is at using its assets to generate profits. The higher the ROA, the better, because the company is earning more money on less investment. The lower the profit per rand of assets, the more asset-intensive a business is. The higher the profit per rand of assets, the less asset-intensive a business is. All things being equal, the more asset-intensive a business, more money must be reinvested to continue generating earnings.

Figure 13 indicates that company A`s ROA slightly increased and was higher than one of the merging partners (data for the other merging partner was unavailable). On the contrary, Figure 14 indicates that Company B reported lower ROA than one of the merging partners. Thus the data available was inconclusive as whether mergers resulted in an overall improved ROA but builds up a question or confirms the hypothesis that in most cases when mergers result from two or more firms, one of the mergers partners is more likely to be much more successful as compared to the other merging partner.

Figure 13: Return on assets of company A and its merging partner

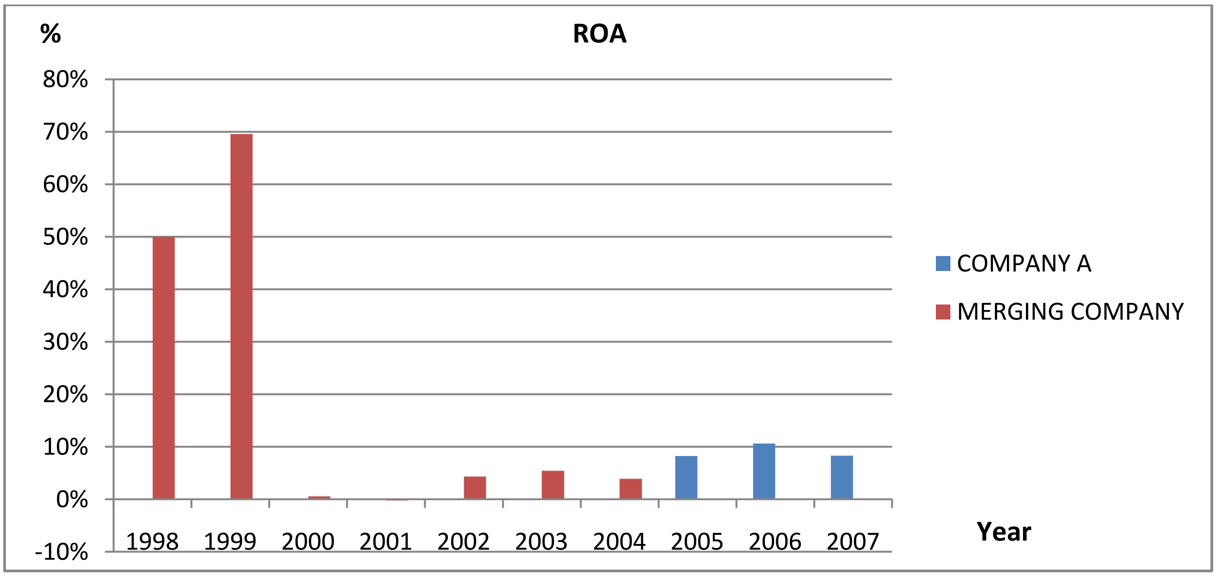
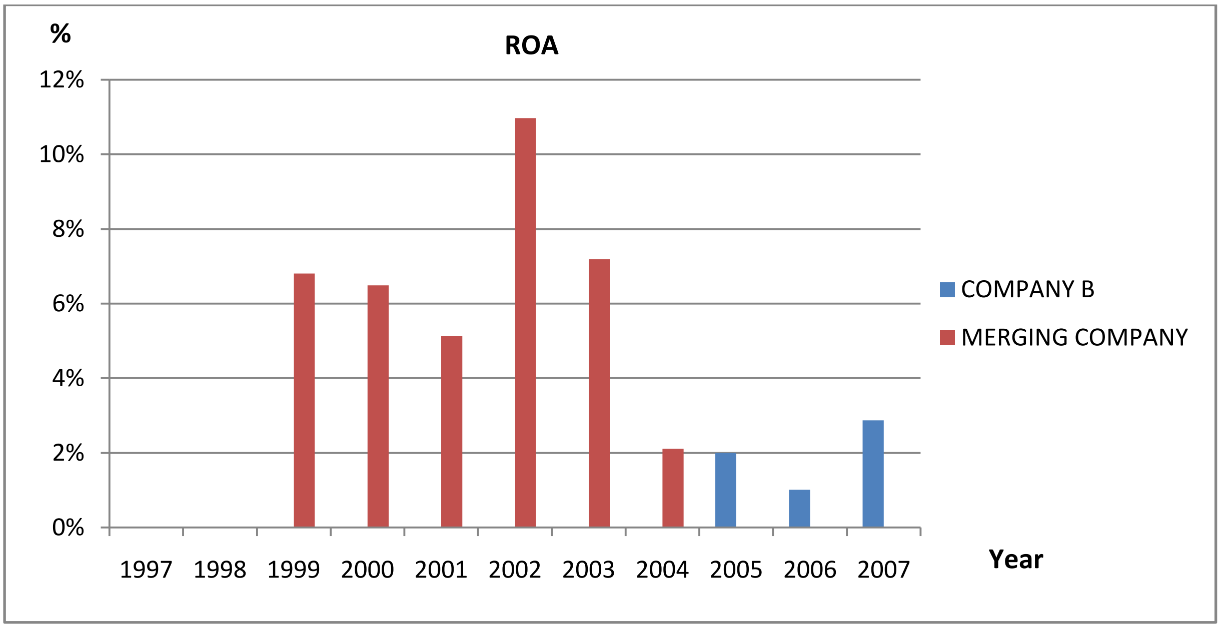
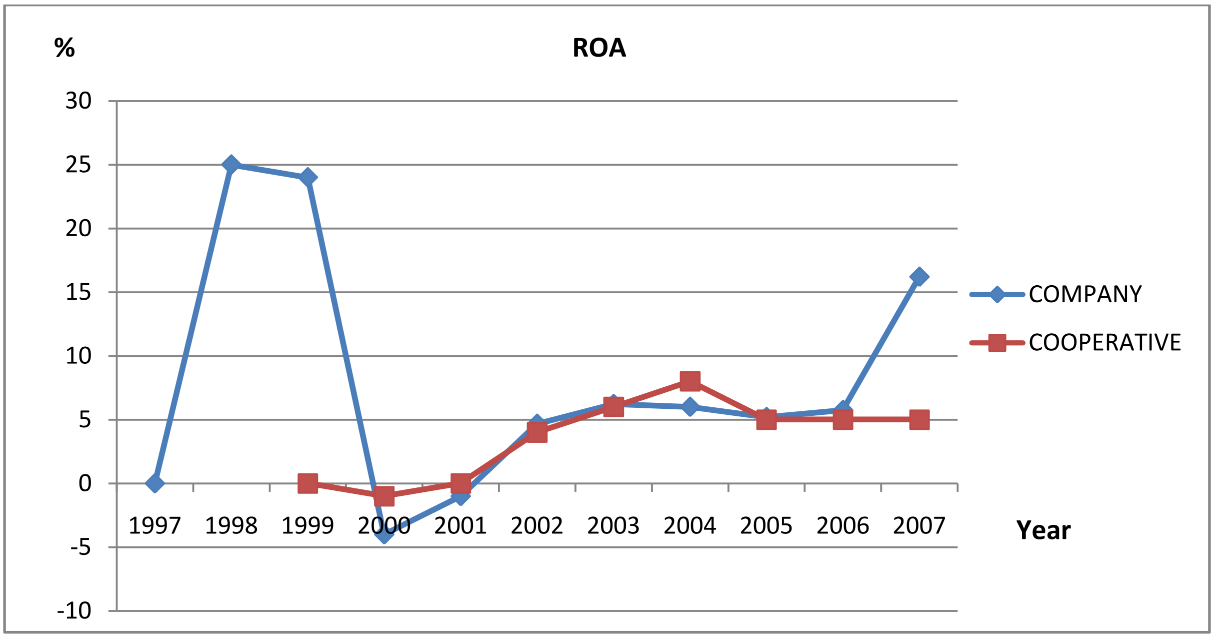


Figure 14: Return on assets of company B and its merging partner



The PWC benchmarking survey states that the standard R.O.A for agribusinesses is about 10.91 (for the year 2006). Figure 15 shows that the agribusinesses under survey have a ROA below the industry average of 10.91 except for the years 1998, 1999 and 2007 when companies recorded a relatively higher ROA than the industry average. Figure 15 show that cooperatives reported a higher ROA than companies from the year 2000 to 2005. Companies had a higher ROA for the years 1999 and 2007. Thus contrary to expectations that companies will have a higher ROA due to their profit motive and the problem of under investment prone in cooperatives, evidence from the study shows that cooperatives perform relatively better in terms of ROA (although the difference is relatively small). However, the results show that while cooperatives had a higher ROA than companies from the years 2000 to 2005, they have been losing this advantage after the year 2005 whereas companies are gaining advantage and reporting increasing and higher ROA.

Figure 15: Return on assets of cooperatives and companies



7.2.3. Return on equity (ROE)

Return on equity (ROE) measures the return earned on owners' equity investment. A high ROE shows that the business creates a lot of shareholder equity and is a sound investment because the original investors will be repaid with the proceeds that come from the business operations. A ROE that is less than the ROA indicates unproductive use of borrowed funds. If ROA is sound and debt payments are under control, improving ROE is a sign of successful management. On the other hand, if ROA is declining, or the company does not appear financially sound enough to withstand troubled times, improving ROE could be just a temporary illusion or an indication of serious trouble (Gitman, 2000).

Evidence from the study shows that when comparing ROE of merged companies, consistent observations as those shown in profit margin and ROA stand. Figure 16 indicates that after the merger and formation of Company A, Company A`s ROE slightly increased or was higher than one of the merging partners (data for the other merging partner was unavailable). Comparatively, Figure 17 indicates that after the merger, Company B had a lower ROE than one of the merging partners. However, the ROE of company B is increasing yearly.

Figure 16: Return on equity of company A and its merging partner

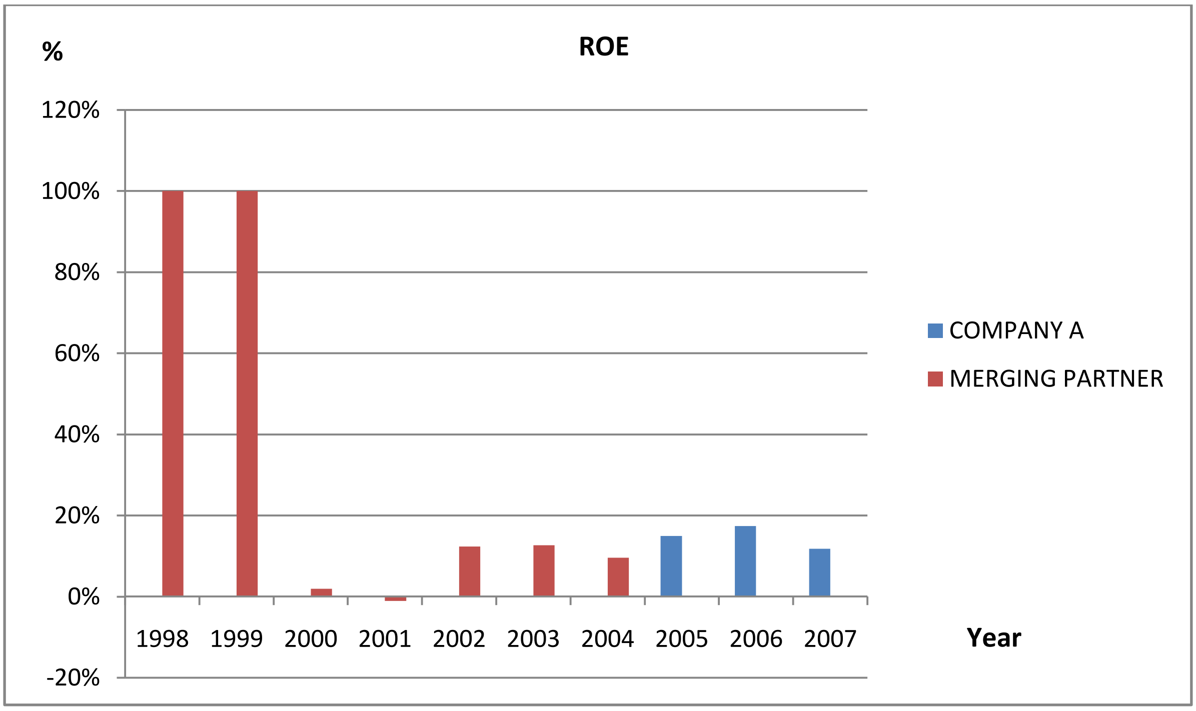
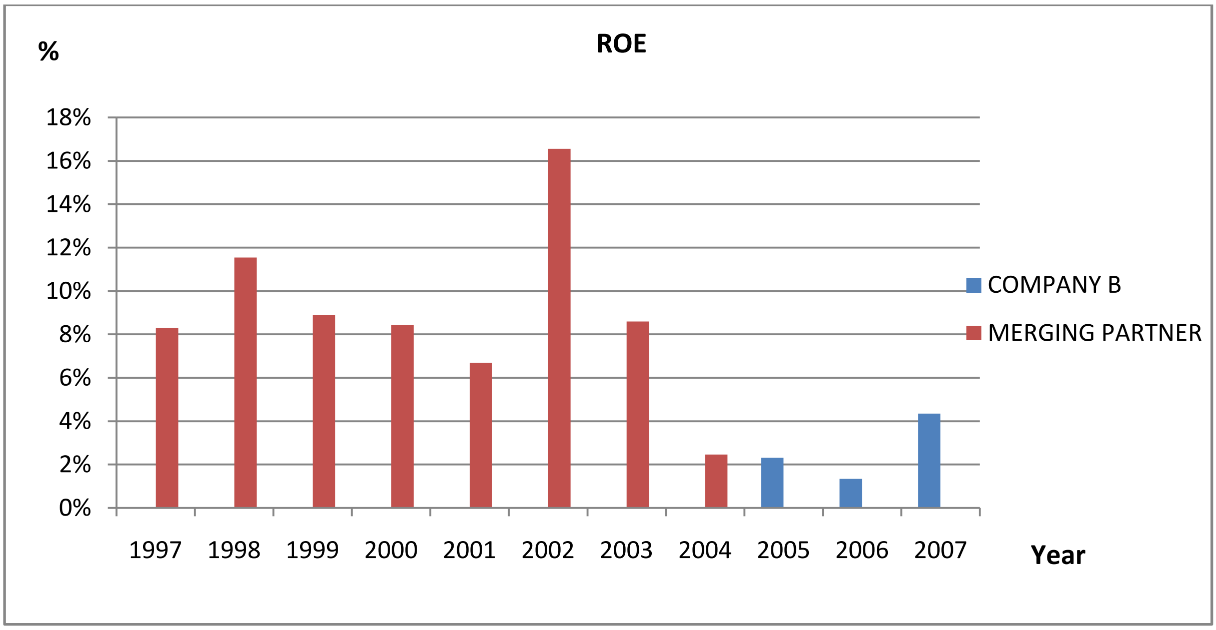
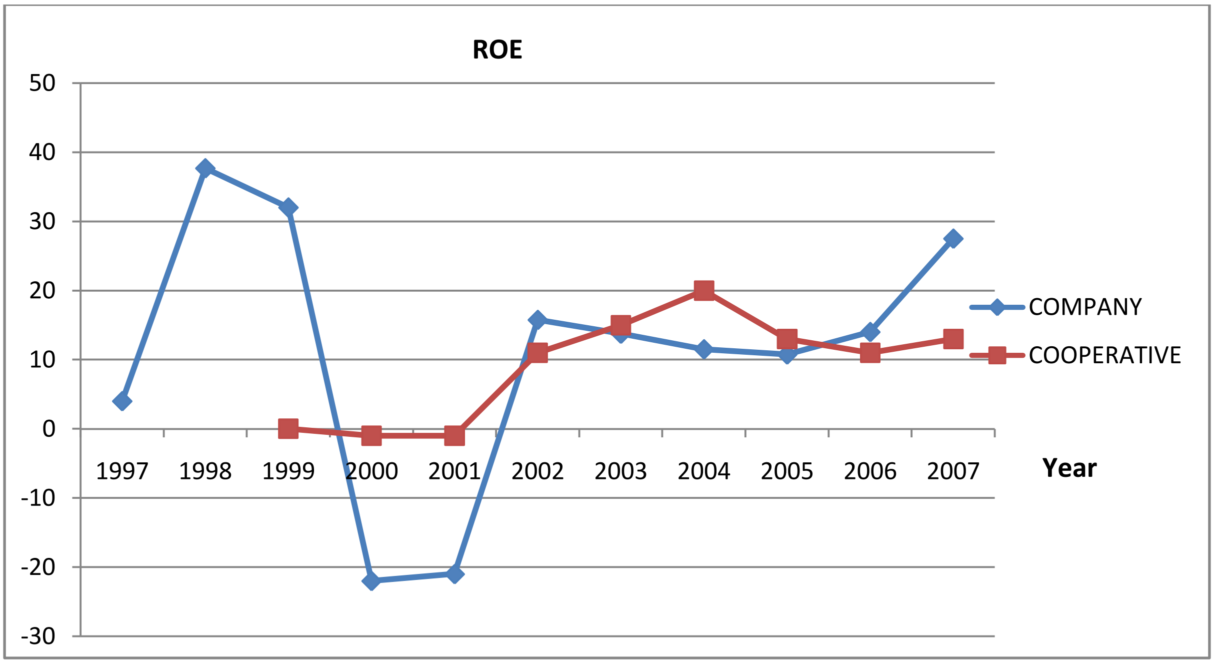


Figure 17: Return on equity of company B and its merging partner



The comparative performance of cooperatives and companies as measured by ROE shows fluctuations. Figure 18 indicates that cooperatives show dominance in performance in the years 2000, 2001, 2003, 2004 and 2005, whereas companies show a better performance in the years 1999, 2002, 2006 and 2007. Results on ROE also confirm that cooperatives are beginning to lose their performance advantage whereas companies show relatively higher performance gains than cooperatives from the year 2005 to 2007.

Figure 18: Return on equity of cooperatives and companies



7.2.4. Current ratio

The current ratio measures the firm's ability to meet its short term obligations by comparing current assets to current liabilities. A ratio less than one suggests that the company would be unable to pay off its obligations if they came due at that point. However, this does not necessarily mean that it will go bankrupt as there are many ways to access financing, but it is definitely not a good sign. A current ratio ranging from 1.5 to 2 is generally considered acceptable and shows that the firm has good short-term financial strength. Gitman (2000) states that when the current ratio is very high, for example more than three, it is not desirable because it means that management has so much cash on hand that could be used for better purposes such as (i) expanding business operations, (ii) investing in short term securities and earning interest.

Figure 19 indicates that company A`s current ratio has remained fairly stable between one and 1.5 with only small annual increases. When compared to one of its merger partner, company A shows that its merger partner initially had a higher current ratio but mainly in the acceptable range of between one and two which has been fairly stable over the years. On the contrary, Figure 20 indicates that after the merger, company B reported a decreasing trend in its current ratio, from about 2.5 in 2005 to slightly above one in 2007. The current ratio of company B`s merger partner fluctuates between 2 and 3 from the years 1997 to 2003, with a significantly higher and undesirable ratio of above 5 in 2004. What can be drawn from the analysis is that after their mergers, both companies have a kept their current ratio lower, in the range of between 1 and 1.5 in the last two years (2006 and 2007).

Figure 19: Current ratio of company A and its merging partner

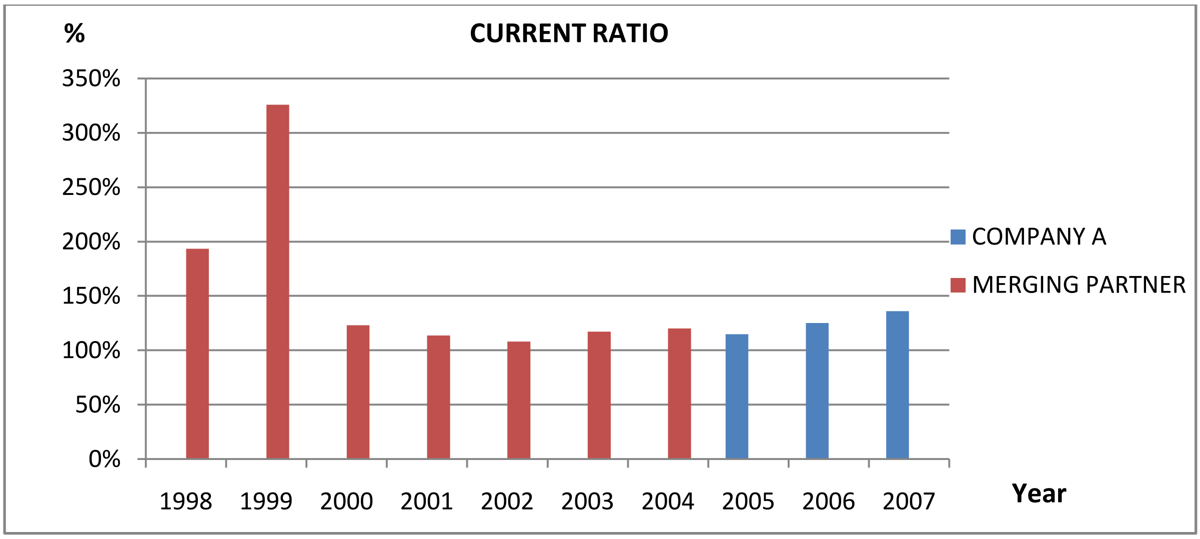


Figure 20: Current ratio of company B and its merging partner

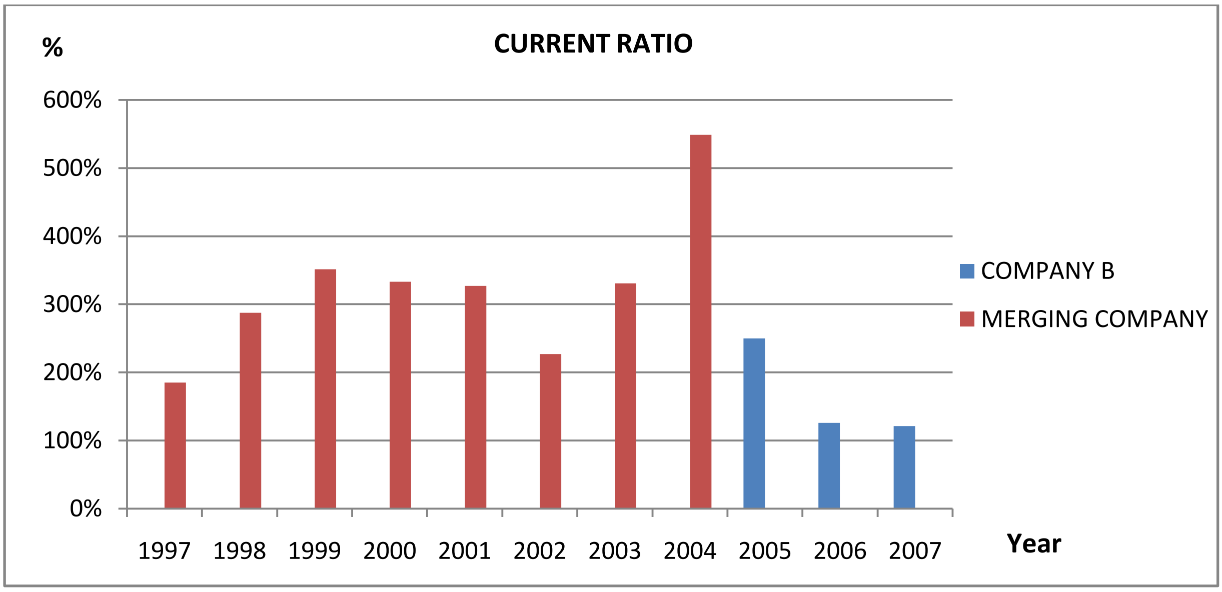
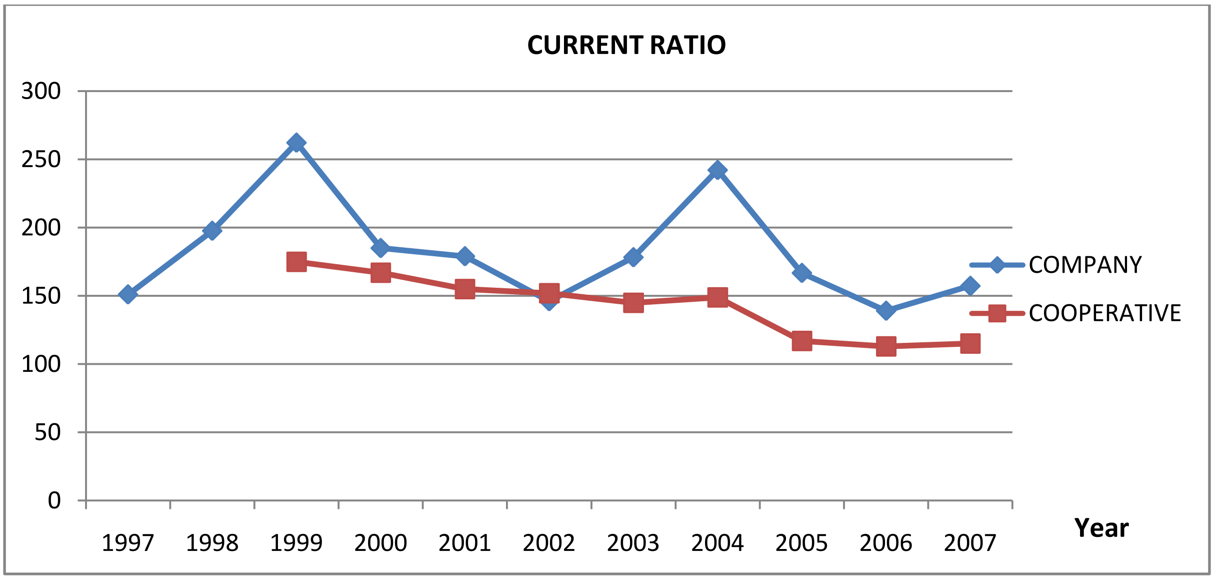


Figure 21 shows that the current ratio of cooperatives has remained relatively stable (between one and two) from 1999 to 2007. On the other hand, companies have maintained a relatively higher current ratio (between 1.5 and 2.5) over the same period.

Figure 21: Current ratio of cooperatives and companies



7.2.5. Debt to asset ratio

The debt to asset ratio measures the ratio of the company's assets that is financed by debt or non-owners. As a result, it is an excellent measure to check the business's long-term solvency. A high debt to asset ratio may indicate potential problems for the business to meet its debt payments or alternatively can also point to a rapidly expanding firm that is using debt successfully to expand its business. If the company can produce returns on borrowed capital that exceed the cost of those funds, it can continue to successfully expand its debt/asset ratio. A debt to asset ratio of less than 50 percent is considered acceptable (Gitman, 2000).

Figure 22 shows that company A increased its debt to asset ratio to 100% after the merger, and has been consistent for the years 2005 to 2007. Comparatively, company A`s merging partner had a very low debt to asset ratio (less than 50%) in 1998 and 1999, and around 60% for the years 2000 to 2004. Figure 23 show that company B also increased its debt to asset ratio after the merger, from a low of 14% to about 34%. Company B has a significantly lower ratio than Company A. Conclusively, companies formed by the mergers indicate the trend to increasing debt to asset ratio after the mergers, possibly because of their increased credit worth (thus they can easily take up more debt) and/or their need for further investments after the mergers.

Figure 22: Debt to asset ratios of company A and its merging partner

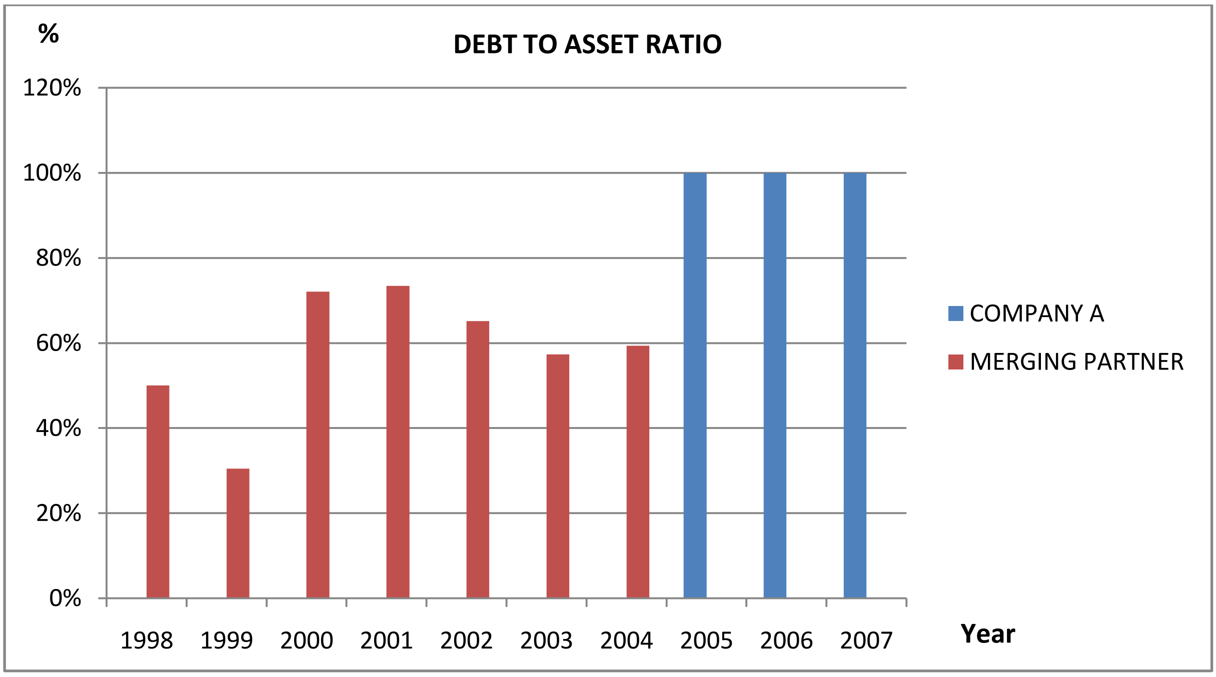


Figure 23: Debt to asset of company B and its merging partner

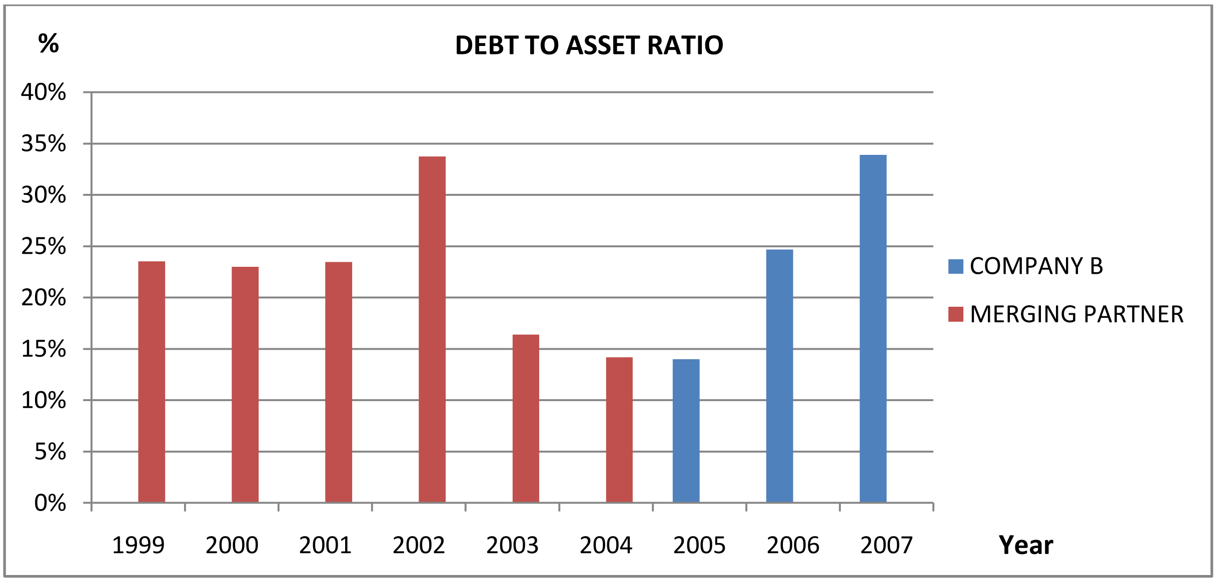
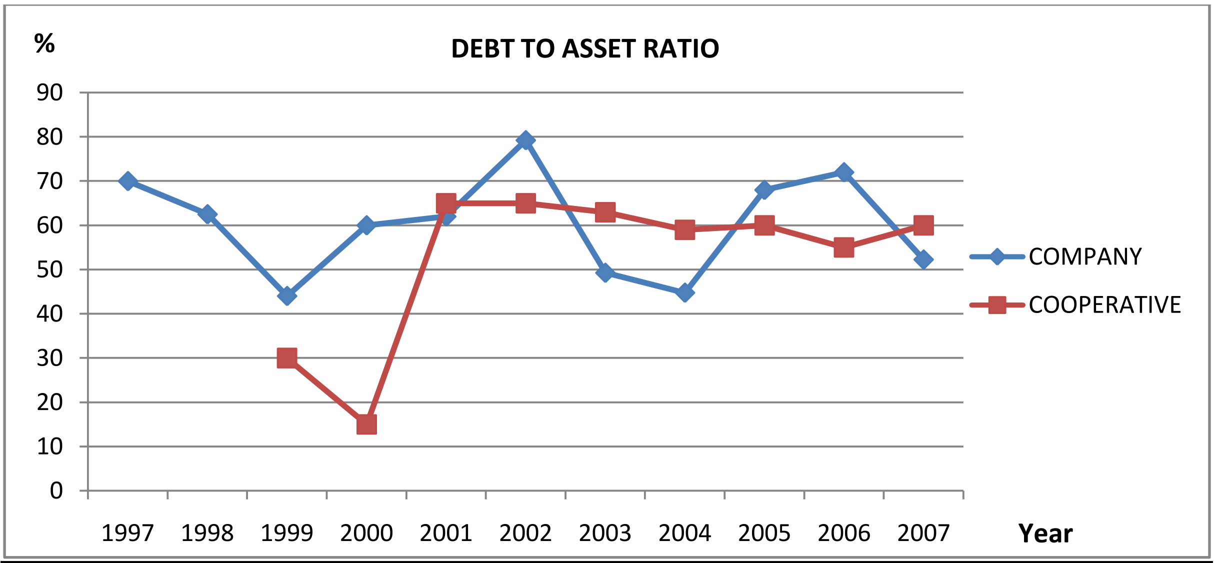


Figure 24 shows that all the agribusinesses had a debt to asset ratio of less than 100%. Figure 25 shows that the debt to asset ratio of companies fluctuates around 40 to 80% and is usually above that of cooperatives except for the years 2003, 2004 and 2007. Cooperatives on the other hand have maintained their debt to asset ratio at between 55 to 65% from the year 2001 to 2007, with the exception of the years 1999 and 2000 were a ratio of 30% and 13% was reported respectively. Conclusively, cooperatives consistently maintained significantly lower debt to asset ratios than companies. This could be attributable to the debt financing power of companies as compared to cooperatives.

Figure 24: Debt to asset of cooperatives and companies



7.2.6 Asset turnover ratio

Asset turnover is an efficiency ratio that shows the sales or revenue produced for every rand of assets owned. Asset turnover ratio reflects how efficiently business assets generate revenues, thus a high asset turnover ratio means that the business is using its assets more efficiently. Gitman (2000) states that an asset turnover ratio is also used to analyze if the business` growth in assets base is keeping pace with its sales. The higher the asset turnover ratio then the more desirable it is for the business.

Figure 25 shows that before the year company A was formed, its merging partner recorded its lowest asset turnover ratio of 59% even though from the period 1998 to 2003, it recorded ratios of at least 110%, with an impressive 1181% in 1998 (probably because the company was starting and had not made significant asset investments). However, after the merger, company A`s asset turnover has remained fairly stable at a low (relative to the merging partner) of about 69 to 89%. Figure 26 showing company B also confirms the same trend, after the merger, company B shows a decreasing asset turnover ratio from 60% to 54% from 2005 to 2007 respectively. On the contrary, company B`s merging partner had an asset turnover ratio ranging from 60 to 100% between 1998 to 2004. Thus the data available indicates that the asset turnover ratios of the companies decreased when the mergers took place.

Figure 25: Asset turnover ratio of company A and its merging partner

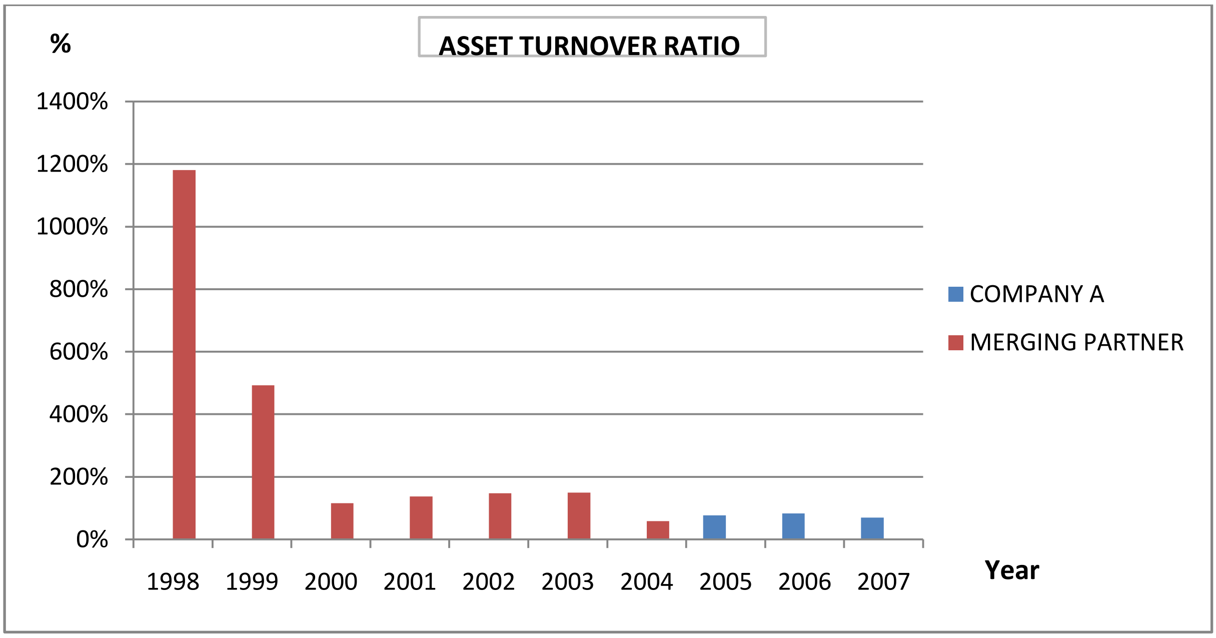


Figure 26: Asset turnover ratio of company B and its merging partner

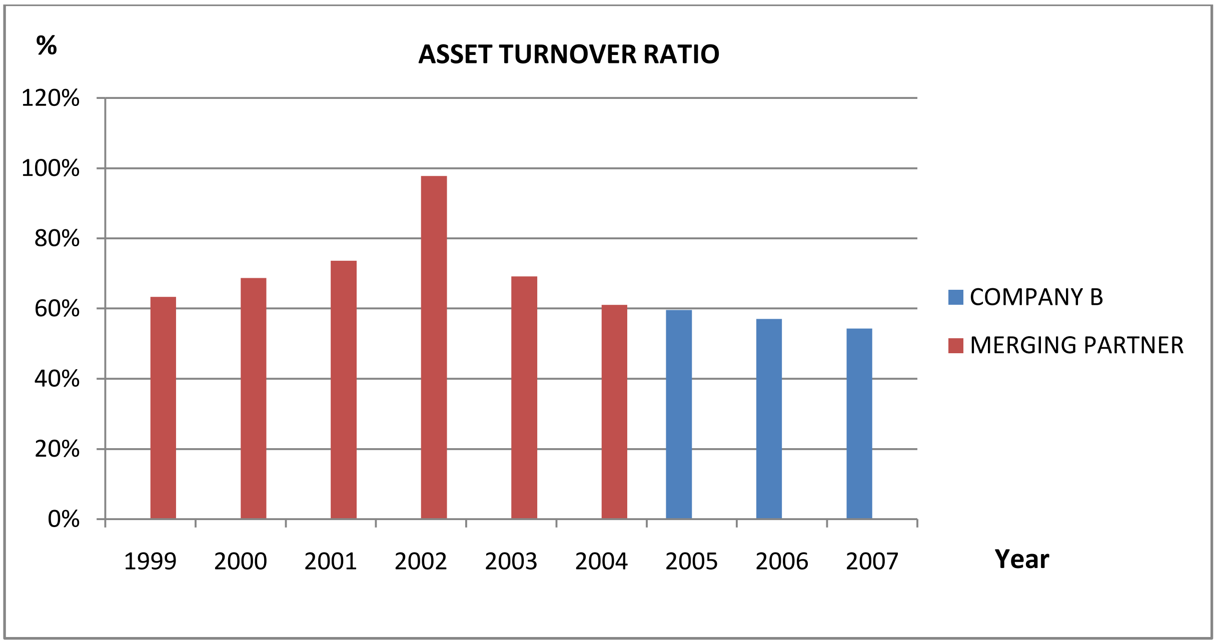
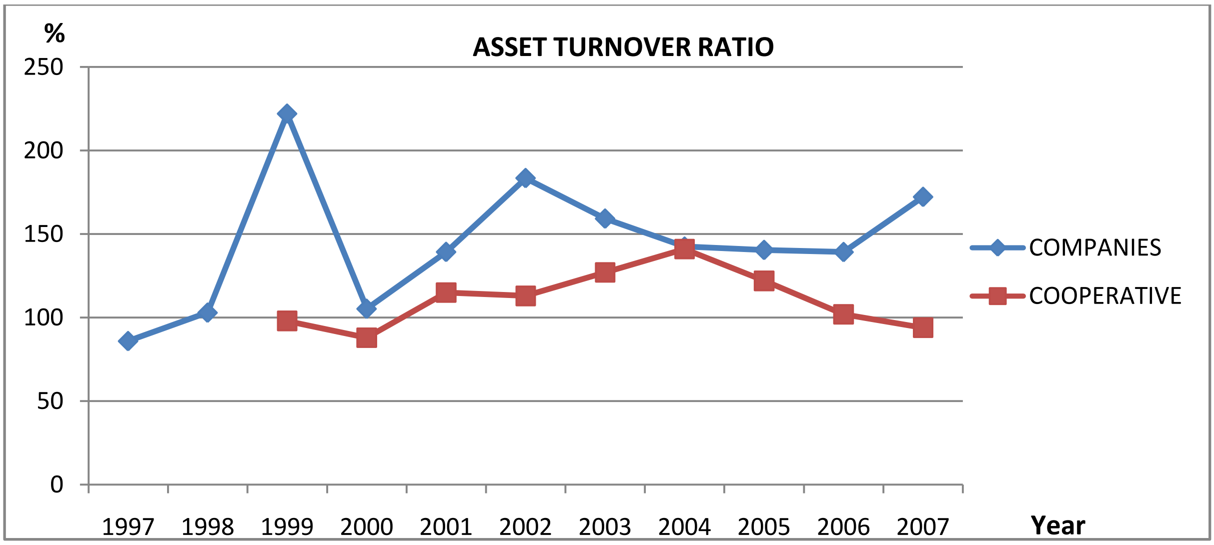


Figure 27 shows that throughout the whole time period under review, cooperatives had a stable and significantly lower asset turnover ratio than companies (ranging from 88% to 141%). Comparatively, companies show very wide fluctuations in asset turnover ratio from the year 1997 to 2004, and then from 2005 to 2007 the ratio is fairly stable (141% to 160%). Even though cooperatives have been improving their asset turnover from the year 2000 to 2004, they start to show a decreasing trend from the year 2005 to 2007 whereas companies are reporting increasing trends in the past two years. Thus once again, cooperatives are decreasing in performance (becoming more inefficient).

Figure 27: Asset turnover ratio of cooperatives and companies



7.2.7. Asset growth

Business firms need to invest in assets in order to be competitive. Such asset investments include investing in productive processing facilities or processes that improve the efficiency of their operations. Of importance is that asset growth should result in improved revenues, profitability and efficiency. A sustainable and positive asset growth is usually desirable for any business. Figure 28 shows that company A`s assets increased and are higher than its merging partner. The same observation applies for company B as shown in Figure 29. Thus the results seem to suggest that assets grew after the mergers and have been increasing which is expected because of the combined asset value of the merging firms and the drive to continuously invest in assets to improve competitiveness.

Figure 28: Total assets of company A and its merging partner

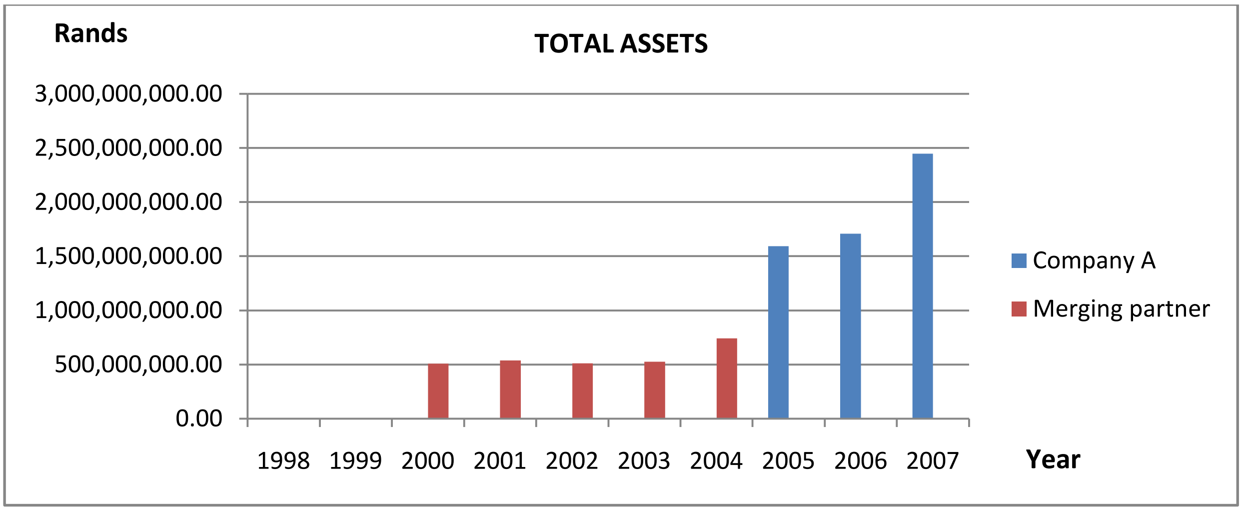


Figure 29: Total assets of company B and its merging partner

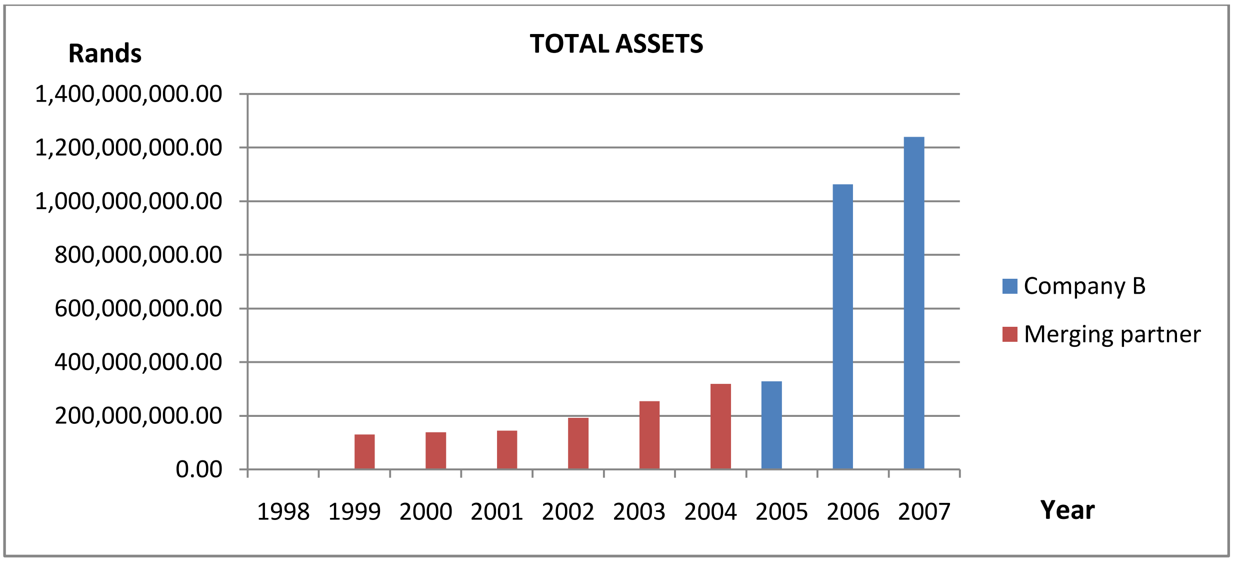
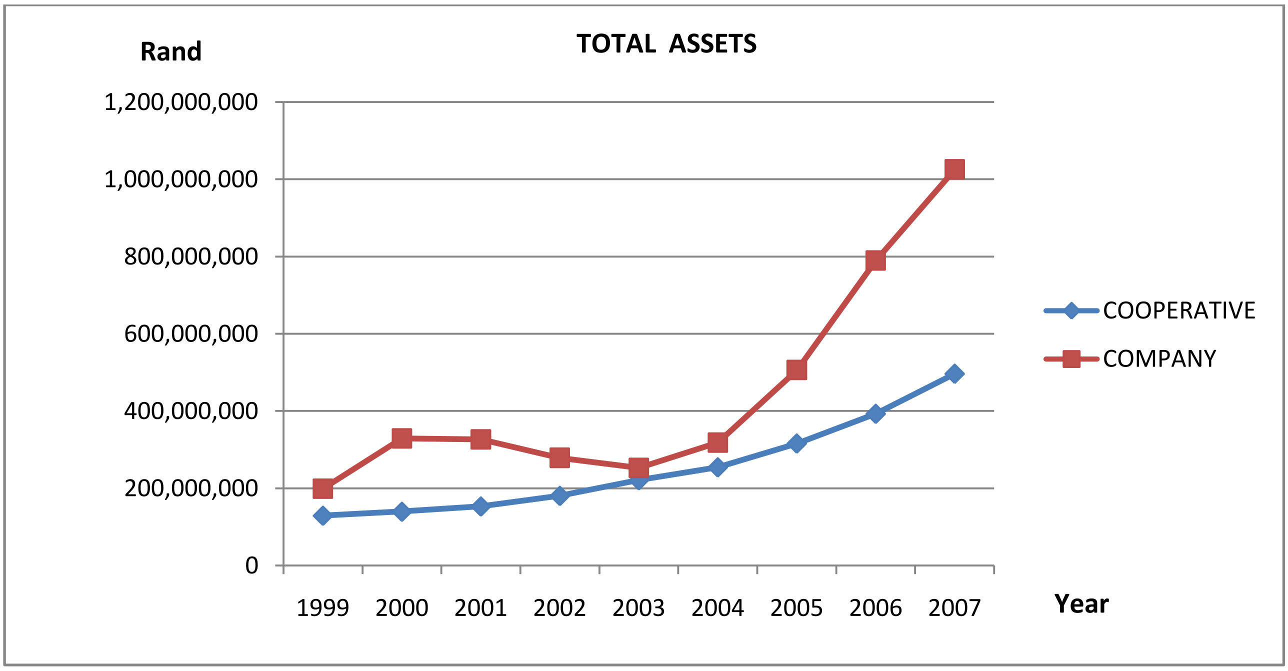


Figure 30 shows that both companies and cooperatives have been reporting stable increases in assets from the year 1999 to 2007. Companies show a superior advantage over cooperatives throughout the whole period as they reported higher asset growth especially from 2003 to 2007. Asset growth in both companies is mainly attributed to acquisitions, mergers, horizontal integration, vertical integration as indicated in Table 6. Of major note, is that cooperatives invest in both non-cooperative and cooperative ventures thus they have also experienced asset growth comparable to companies.

Figure 30: Total assets of cooperative and companies



7.2.8 Revenue growth

Revenue growth shows how firms have been able to expand their businesses, more specifically sales. Gitman (2000) states that good revenue growth improves profits, is sustainable over time, does not use unacceptable levels of capital and is also primarily internally generated. Revenue growth reflects the growth of the business more specifically the income from sales and other sources available annually to cover expenses, loan payments, family living, income taxes, expansion, etc. Revenue growth is an important financial ratio because it is essential for a company's shares to be attractive to investors as revenue is used as an indication of earnings quality. In addition, there are several financial ratios attached to it, the most important being gross margin, profit margin, asset turnover ratio and net income ratio.

Figure 31 shows that company A managed to increase its revenue growth after the merger as it reported higher gross revenues than its merging partner. Percentage growth in revenue as shown in Figure 32 also confirms this observation by showing that the merging partner reported a negative revenue growth the year before the merger. After the merger, company A increased revenues by 16% and 20%. Figure 33 and Figure 34 indicate that company B also shows the same trend noted in company A. After the merger, company B reported higher increases in gross revenues. Thus the data available indicates that the revenues of the companies increased when the mergers took place.

Figure 31: Revenue growth of company A and its merging partner

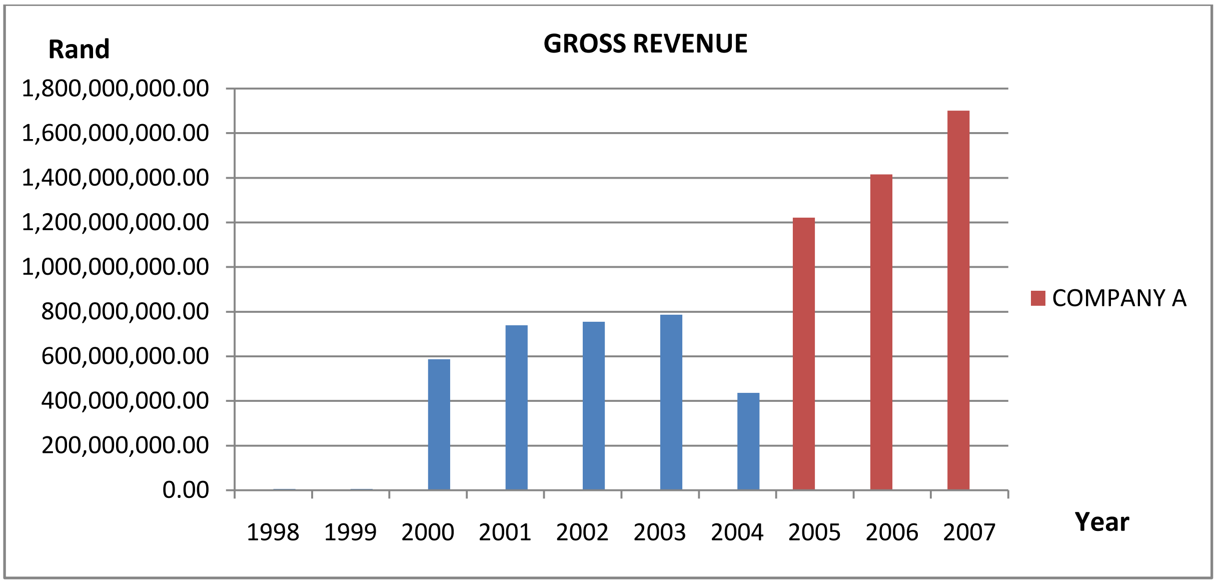


Figure 32: Percentage growth in revenue of company A and its merging partner

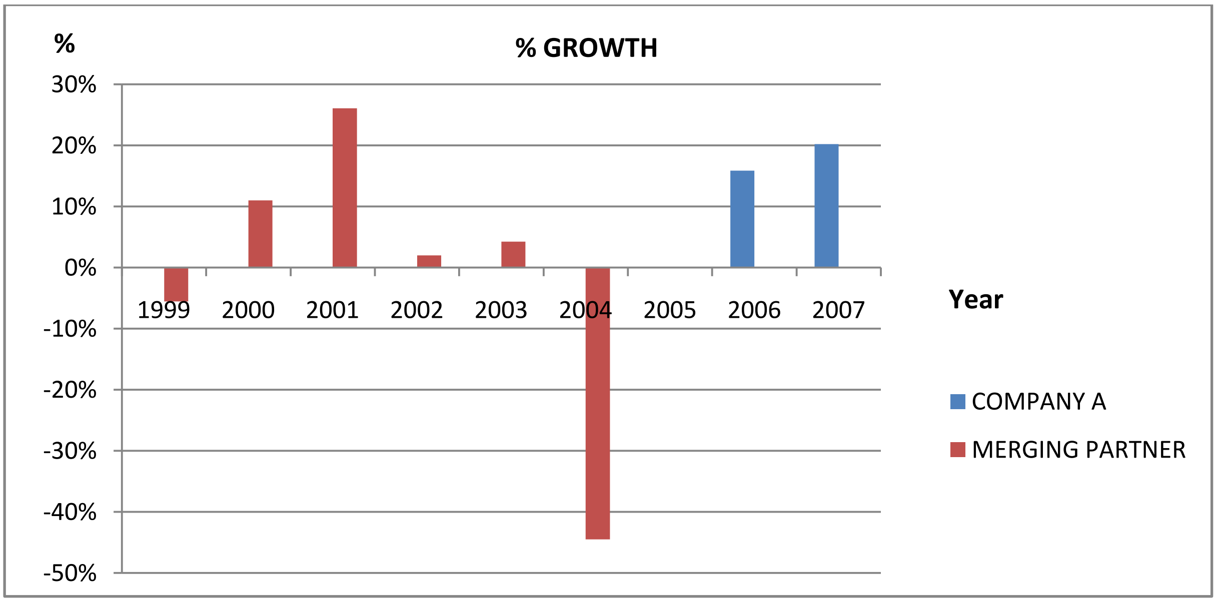


Figure 33: Revenue growth of company B and its merging partner

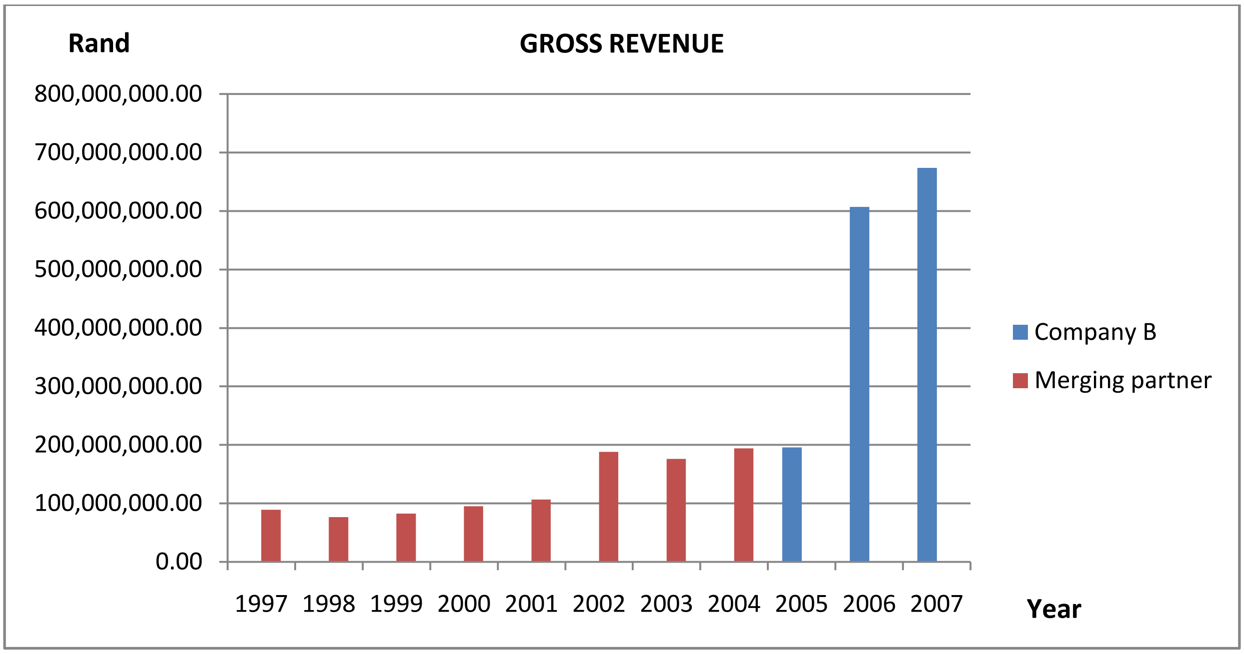


Figure 34: Percentage growth in revenue of company B and its merging partner

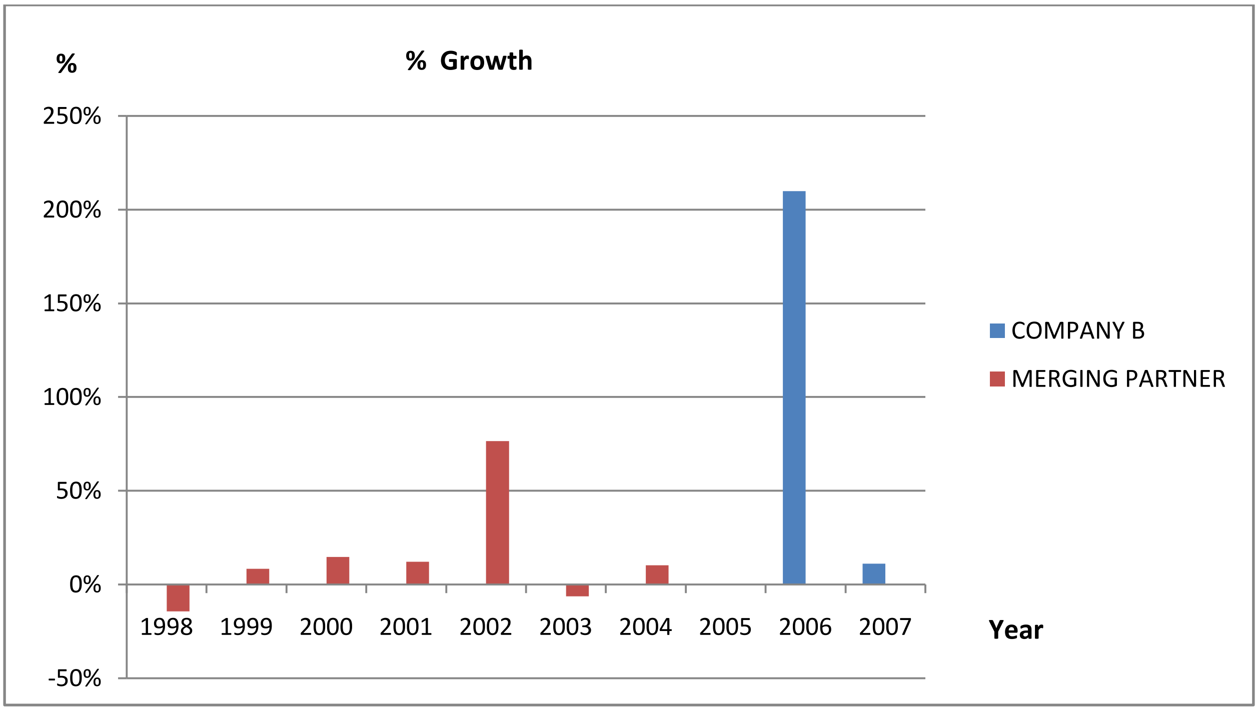
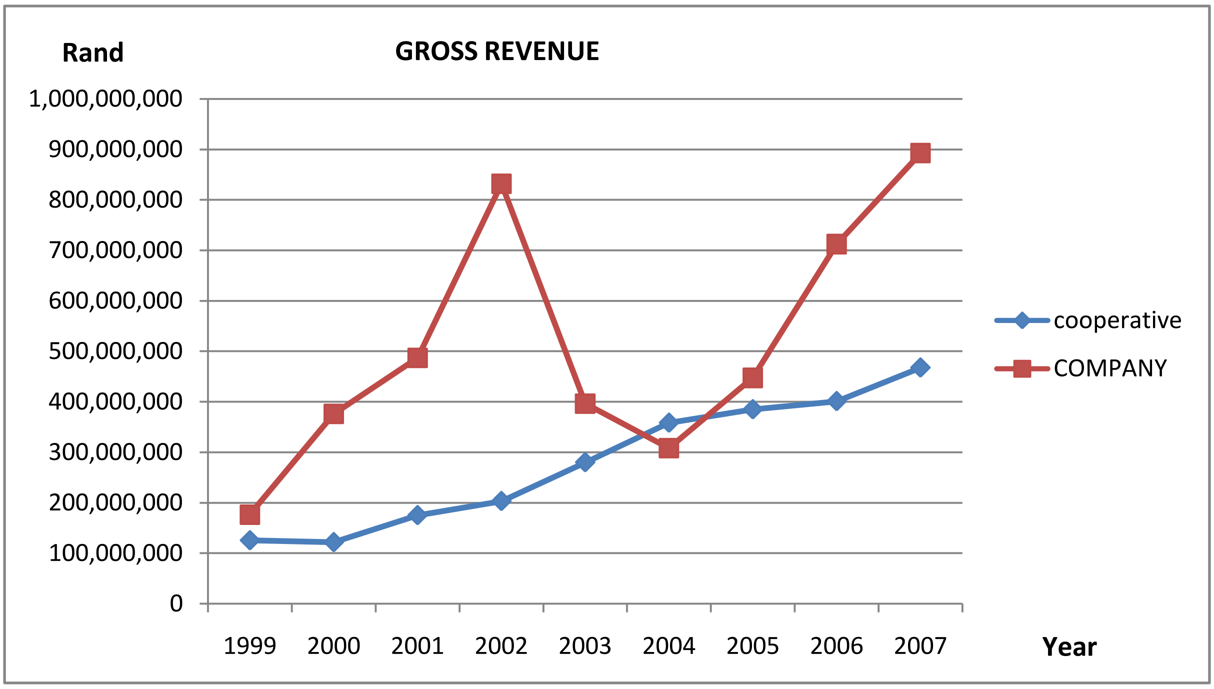


Figure 35 shows that through the whole period under review, cooperatives and companies reported increasing revenues. Companies show wide fluctuations in revenue growth but maintain significantly higher revenues than cooperatives from the year 1997 to 2007. On a positive note though cooperatives show stable increases throughout the period under review. Interestingly, both cooperatives and companies show revenue or profit from sales of assets after a year or two of acquiring other firms. This prompts or suggests evidence of asset stripping[3]. After a year or two from the purchase or acquisition of other businesses the agribusinesses have recorded income from the sale of assets thus indicating that there is prevalence of the purchase of companies in order to strip their assets and make a profit.

Figure 35: Revenue growth of cooperatives and companies



7.3 Economic value added

Figure 36 shows that after the merger, company A created value for the shareholders as compared to one of its merging partner that actually destroyed value for the shareholders investments (data for the other merging partner was unavailable). On the contrary, Figure 37 shows that after the merger and its formation, company B destroyed value for its shareholders than its merging partner. Thus the data available was inconclusive as whether mergers resulted in an overall improvement in shareholders' value, but confirms the observations that are consistent with the other financial ratios that in most cases when mergers result from two

[3] Asset stripping is the process of buying an undervalued company with the intent to sell off its assets for a profit.

or more businesses combining to form one firm, one of the mergers partners is more likely to be much more successful and doing well as compared to the other merging partner.

Figure 36: Economic value added of company A and its merging partner

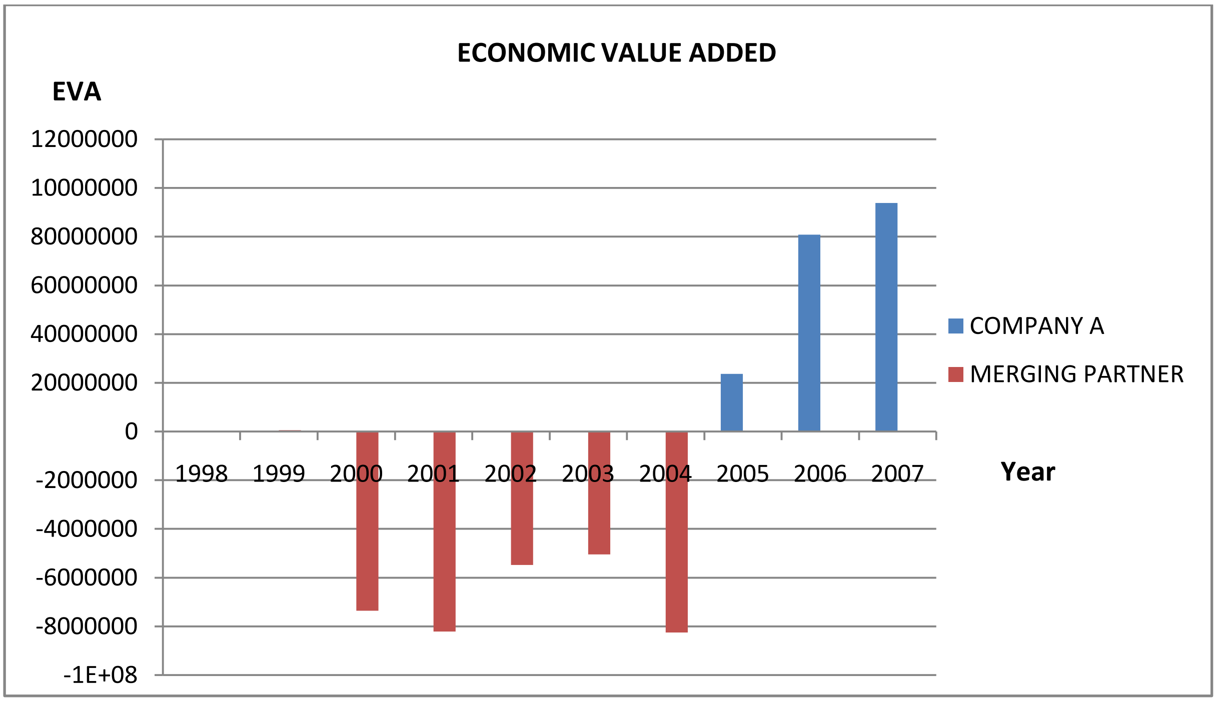
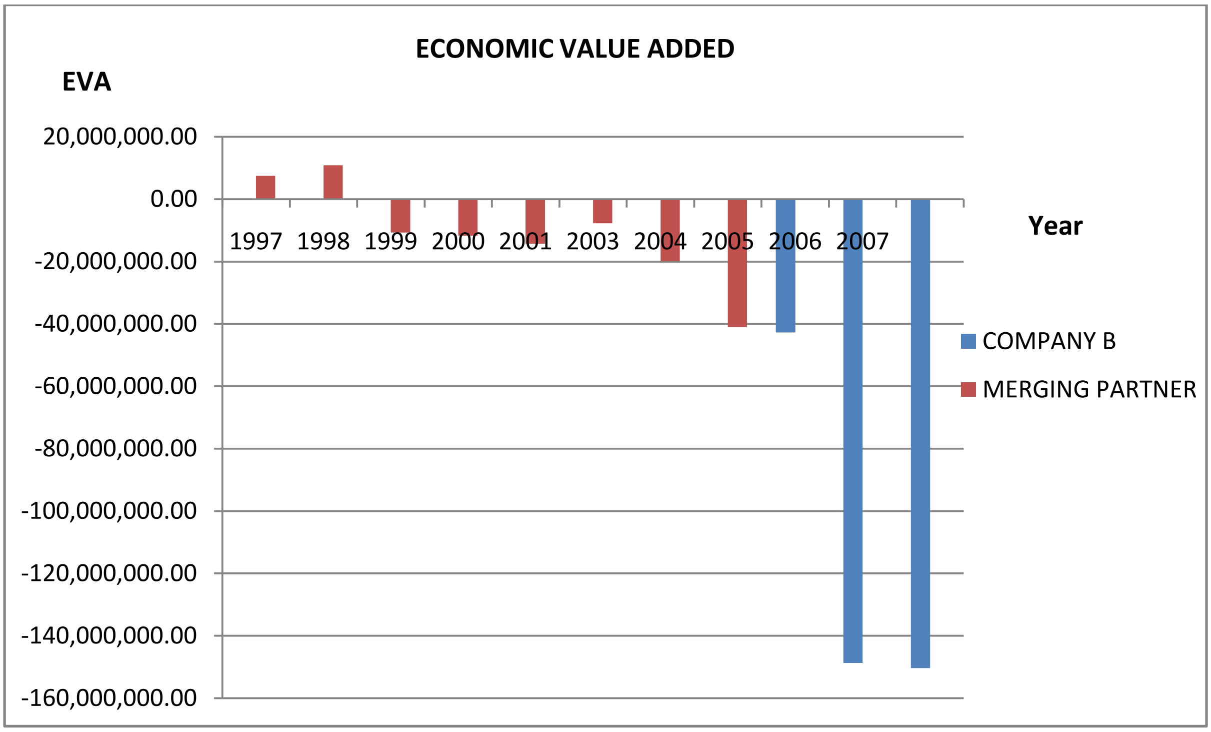
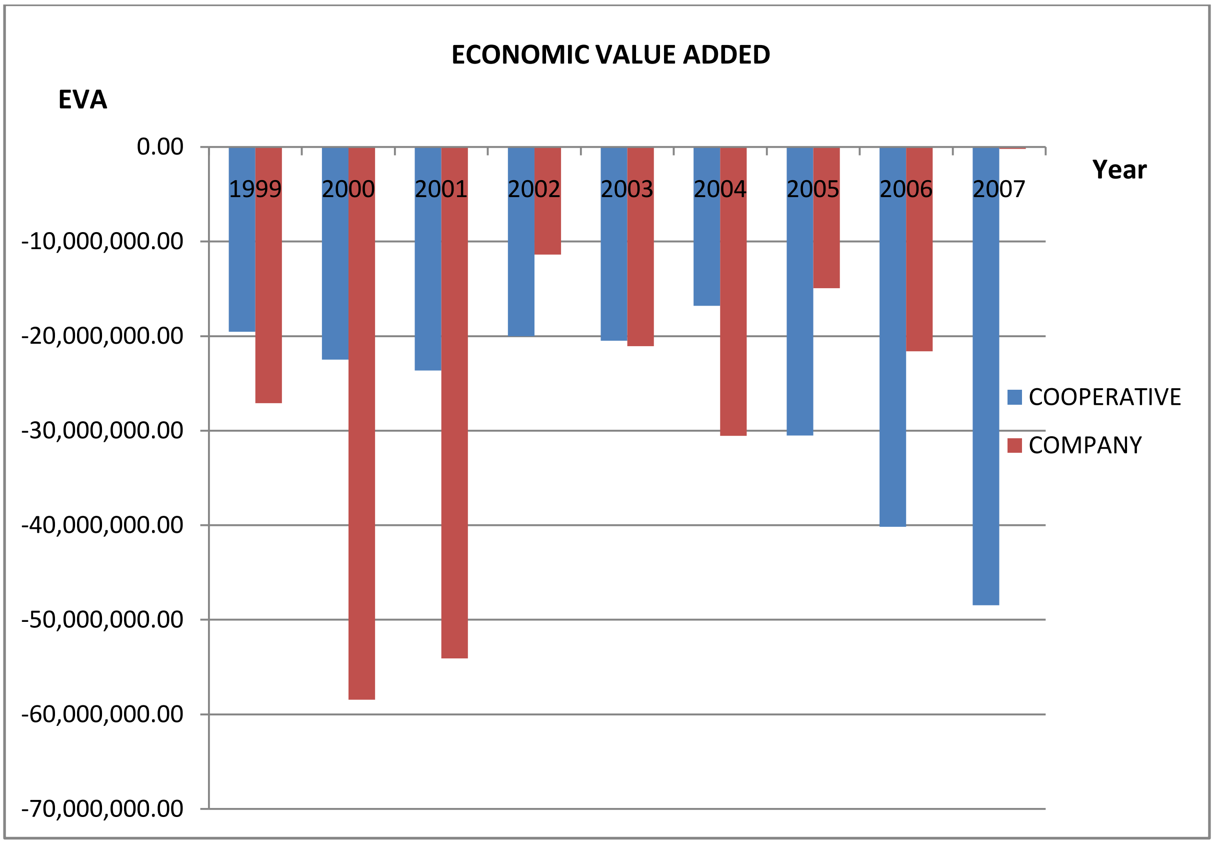


Figure 37: Economic value added of company B and its merging partner



When comparing averages, both cooperatives and companies destroyed value for their shareholders. However, Figure 38 shows that companies are improving significantly as they show a movement towards a positive EVA. Cooperatives are continually destroying shareholders value as their EVA seems to be getting worse and more negative.

Figure 38: Economic value added of cooperatives and companies



7.4 Summary

- The data available was inconclusive as whether mergers resulted in improved financial performance or not. Because the two companies formed by mergers consistently gave contradicting results in the entire financial ratios except for revenue growth, asset growth, asset turnover ratios and debt to asset ratio. The probable explanation for this observation is that in most cases when mergers take place, one of the mergers partners is more likely to be more successful to the other merging partner. Thus for Company A the merger partner analysed in this study seems to be the better performing merger partner, whereas for Company B, the merger partner reviewed is likely to have been the lesser performing merger partner.

- Results confirm that companies had a relatively higher profit margin than cooperatives for most years except from 2003 to 2005 (albeit a small difference).
- Cooperatives show that they have a higher ROA than companies from the year 2000 to 2006. Companies had a higher ROA for the years 1999 and 2007. Thus contrary to expectations that companies will have a higher ROA due to their profit motive and the problem of under investment in cooperatives. Evidence from the study shows that cooperatives perform relatively better in terns of ROA (although the differences is relatively small). However, the results show that while cooperatives initially had higher ROA than companies, they have been losing this advantage from the year 2005.
- There are fluctuations in as far as ROE between cooperatives and companies. Cooperatives show dominance in performance from the years 2000, 2001, 2003, 2004 and 2005, whereas companies show a dominance or better performance in the years 1999, 2002 and from 2005 to 2007. Results on ROE also confirm that cooperatives are beginning to decline in performance whereas companies show relatively higher performance gains from 2005 to 2007.
- The current ration of companies has been higher than that of companies throughout the time period.
- The debt to asset ratio of companies fluctuates around 40 to 80%, and is usually above that of cooperatives except for the years 2003, 2004 and 2007.
- Cooperatives had significantly lower asset turnover ratio than companies. Even though cooperatives have been improving their asset turnover from the year 200 to 2004, they start to show a decreasing trend from the year 2005 to 2007. Whereas companies have shown slight fluctuations and reported increasing trends in the past two years.
- Companies and cooperatives have been reporting stable increases in assets from the year 1999 to 2007. Companies show a superior advantage over cooperatives as they reported higher assets and higher growth especially from 2003 to 2007.
- Cooperatives and companies reported increasing revenues. Companies show wide fluctuations in revenue growth but maintain significantly higher revenues than cooperatives from the year 1997 to 2007. On a positive note though is that cooperatives show stable increases throughout the period under review.

- Both cooperatives and companies destroyed value for their shareholders. However, companies are improving significantly as they show a movement towards a positive EVA. Cooperatives are continually destroying shareholders value and their EVA seems to be getting more negative.
- Overall, companies had the strongest relative performance in most of the financial ratios mainly profit margin, ROE, current ratio, debt to asset ratio, asset turnover ratio, asset growth, revenue growth and EVA, and their relative performance was improving.
- Cooperatives only show a clear advantage on ROA and sometimes ROE.
- Conclusively, the performance of cooperatives is only slightly lower, with no big significant difference from companies. However, the concern is that in the past two years, cooperatives seem to be reporting decreasing performance thus significantly losing their advantage in most of the financial ratios.

CHAPTER EIGHT
SUMMARY, CONCLUSION AND RECOMMENDATIONS

8.1 Summary of the results

This study provided a holistic analysis of the implications of converting from a cooperative to a company by analysing the comparative performance of cooperatives and companies. The summary of the research questions and findings as are briefly stated below.

i. How has the conversion to companies affected performance? Do cooperatives that have adopted the company business model perform better than cooperatives that never converted?

Companies had the strongest relative performance in most of the financial ratios mainly profit margin, ROE, current ratio, debt to asset ratio, asset turnover ratio, asset growth, revenue growth and EVA. Cooperatives only show a clear advantage on ROA and in some years ROE. Even though, the differences in performance are slightly higher in favour of companies, in the past two years, cooperatives seem to be reporting decreasing performance thus losing their advantage in most of the financial ratios analysed. Based on the financial performance results, operating as a company or converting from a cooperative to a company could result in slight increases in financial performance.

ii. Why have cooperatives converted? What are some of the external or internal reasons and motives that prompted conversion?

The main reasons companies indicated for undergoing structural changes and conversions are, (i) as a response to the deregulation of the industry, (ii) political reasons, (iii) management pressure, (iv) seeking to expand the organization, (v) response to the cooperatives act, (vi) relative merits of the company business model and (vii) seeking to improve the competitiveness of the organization. Response to the deregulation of the industry is cited as the major reason for converting, which is consistent with the observation that most conversions occurred in 1998 after the deregulation of markets and withdrawal of state support.

iii. Are cooperatives necessarily a less efficient organisational structure than the company business model?

Companies show that they are much more efficient than companies. In addition, in the past two years, cooperatives have been becoming even much more inefficient whereas companies improved their efficiency in the past two years.

iv. Which challenges and opportunities were encountered during the process?

Because cooperatives are a different organisation from companies the first major problem encountered during the conversion process was cited as the conflict of interests between management and members. Most such conversions seem to have been initiated by management. Although alternative organisational changes exists e.g. mergers, acquisitions or takeovers, integration, joint venture, that can improve the competitiveness of cooperatives, they do not fully address the property rights challenges that cooperatives face. Thus conversions are the preferred solution to address the ill-defined property rights structure of cooperative.

v. What are the implications of such a change to members in as far as services obtained, shares, control, dividends and member's wealth is concerned?

When the cooperatives converted to companies, members were given an option to be shareholders in the new companies and thus much of the control came as voting rights based on their shareholding which varied depending on members individual`s wealth in purchasing additional shares. Cooperatives distinguish between members and non members as clients by offering discounts to their members, thus offering an incentive to be a cooperative member, whereas companies do not distinguish between members and non members as clients. Of major note is that both companies and cooperatives assisted their member clients to enhance efficiency or profitability because it created value for the firm. Converting to companies thus results in the loss of incentives offered by cooperatives to its members, such a loss should be weighed against the gains from stock returns in a company.

vi. How does the management reconcile the economic self interest of members versus the investors, or the developmental imperative versus the economic viability of the organisation?

A consistent observation in all the companies was that once cooperative members have been admitted as shareholders in the company, the primary objective of the organisation is changed to that of furthering all members interest as investors, thus return on investments, dividends and profitability become of primary interest other than furthering members interest as input suppliers or clients through incentives such as discounts e.t.c. However, both companies and cooperatives assisted their member clients to enhance their efficiency or profitability because it created value for the firm. Thus there appears to be a balance by management to further the interest of members as investors and members as clients even though investors (shareholders) are the ultimate primary focus of companies. As such the economic viability of converted cooperatives seems to be of more importance than its development imperative which is only furthered to a limited extent through corporate social responsibility.

vii. What are the implications of such a change to investors in as far as shares, dividends and return to investments is concerned?

Both cooperatives and companies destroyed value for their shareholders. However, companies are improving significantly as they show a movement towards a positive EVA. Cooperatives are continually destroying shareholders value as their EVA seems to be getting more negative.

viii. How has the organisation adapted to the needs of an advancing industrial society?

Results show that even though companies are more dynamic than cooperatives, cooperatives compare relatively well in all aspects except for their property rights which is mainly a direct result of the Cooperatives Act (Act 14 of 2005) which affects cooperatives not companies. Thus cooperatives can be as dynamic as companies or even better if the Act is revised and consideration is made for commercial cooperatives.

ix. How do converted cooperatives differ to those that never converted in as far as organisation culture, management culture, style, competence and incentives?

Contrary to prior expectations, cooperatives show that they are also embracing change because they have adopted new organisation strategies, structures and culture similar to that of companies. Cooperative management also shows a great deal of dynamism that is closely comparable to companies. Cooperatives scored a dynamism score of 62.33 compared to 83.75 for companies.

8.2 Conclusion of the study

The study indicates that cooperatives compare relatively well to companies although there have potential to do even much better if their property rights structure is addressed. The main shortcomings of cooperative property rights were that of not allowing external investors into the cooperatives and the one member one vote principle for primary cooperatives or the 15% cap for secondary cooperatives. Cooperatives point at the difficulty to adhere to the Cooperatives Act (Act 14 of 2005) and its limitations to adopting modern cooperative trends. Such limitations have left commercial cooperatives with the choice of converting to companies as the ultimate solution to address their property rights structure. As a result, if amendments are not made to the cooperative act, there is an expectation of a continual decrease in the number of commercial cooperatives, with the rise of development or emerging cooperatives which are heavily supported by the new cooperative act and other supporting policies.

Because cooperatives compare relatively well to companies then there is evidence to suggest that there is need to curb such conversions for various reasons. Firstly, it is widely acknowledged that in order for primary agriculture and farmers to increase their wealth and competitiveness they have to at least own a part of the supply chain. Even though both cooperative and companies offer such an opportunity, cooperatives are more member oriented and thus would serve primary agriculture and farmers better than companies that are investor oriented. Companies are expected to appeal because they offer a better investment return than cooperatives, but as shown in the study if cooperatives can compare relatively well in terms of financial performance, then members seeking to further their interest other than a higher return in investment could opt for a cooperative than a company.

8.3 Recommendations and areas for further study

Lessons on cooperative policy and structures can be drawn from other countries mainly the USA and New Zealand. Lobbying for the change of the Cooperatives Act (Act 14 of 2005) in order to accommodate commercial cooperatives seems farfetched given the length of time it took for the Act to be drawn up and passed in parliament. In addition, such a task becomes more challenging because the Act appears to be in line with the political and economic pressure to address the problem of inequity. Thus, given a debate on commercial versus developing cooperatives at this stage in South Africa, developing cooperatives will always win. Therefore, not many changes are bound to be made to the Cooperatives Act (Act 14 of

2005). Alternative options exist, commercial cooperatives or policy makers can push to follow the case of New Zealand where a new type of organisation called the cooperative company has been introduced. Such an organisation in South Africa can thus be introduced and governed by the Companies Act instead of the cooperative Act which is more development oriented. This would make cooperatives much more dynamic and be able to address some of the constraints and challenges they face in meeting the requirements of the Cooperatives Act (Act 14 of 2005).

There are various research areas that need to be done in South Africa on cooperatives. Much of the research is not published and is mainly done for private purposes such as consultancy work. As such, it is difficult to give trace on what has been done and hasn't been done with regard to cooperative research based on publications from the main journals. However, the following issues are recommended for further research.

- The weakness of case studies is that they cannot be generalised and used to provide a conclusion for the whole country. Thus, more case studies need to be carried out to validate and compare the findings of this study.
- Given enough data, specific studies on the implications of mergers and other structural changes such as integration, acquisitions need to be done.
- There are several comparative factors between cooperatives and companies that need to be investigated. For example, investment in infrastructure such as office buildings, processing facilities, the psychological behaviour and state of their employees e.t.c. Some of these factors are beyond the discipline of agriculture economics but do have an impact on the relative performance of firms.
- Finally, there is need to investigate the history of cooperative policy in South Africa, by asking questions such as why, by whom and how cooperative policy is made. Answers to these questions would be important in showing the influences, impacts and future direction of cooperatives and cooperative policy in South Africa.

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Appendice 1: Questionnaire

Questionnaire concerning the comparative performance of cooperatives that converted to companies and cooperatives that never converted

Respondent and Organisations` Information

Name of Organisation	
Sector	
Position of respondent	
Contact Phone No.	
Location of interview	
Date of interview	

Hello, I am **Wellington Sikuka** from **Stellenbosch University** in the Western Cape. We are talking to a cross-section of agribusiness companies and cooperatives in the Western Cape about the issues and implications of converting from a cooperative to a company. Your views will be used to help inform on the much needed insight on cooperative conversions and assist policy makers to make informed decisions on cooperatives or agribusinesses.

This interview is completely confidential. Your name will never be associated with your answers.

I hereby certify that this is an honest interview taken in accordance with my academic needs only. For further information or enquiries you can contact my supervisor **Dr A.M.S Karaan**.

………………………………… ………………………..

Interviewer's Signature Date

SECTION A: ORGANISATIONAL INFORMATION AND CULTURE

Mark with an X or ✓ (tick) were appropriate!

1. How do you consider your competition in the industry?

Light ☐ Strong ☐ Manageable ☐

2. (a) Does your organisation undertake any corporate social investment?

Yes ☐ No ☐

(b) If Yes, please specify what type of investments?

....

....

3. (a) Has your organisation undertaken some environmental sustainability or eco sensitive initiatives?

Yes ☐ No ☐

(b) If Yes, please specify what type of initiatives?

....

....

4. To what extent do you agree or disagree with each of the following statements regarding your organisation?

Strongly disagree 1
Disagree 2
Neutral 3
Agree 4
Strongly Agree 5

	1	2	3	4	5
The leadership style has changed to suit the new environment					
The company can be described as a learning organization					
Team work is an essential structure for the organisations` success					
Organisational culture plays an important role in the success of the organisation					

5. When recruiting new employees, to what extent do you consider diversity?

No extent	
Small extent	
To some extent	
To a large extent	
To a very large extent	

SECTION B: ORGANISATION RESTRUCTURING AND DYNAMISM

Mark with an X or ✓ (tick) were appropriate

6. Please indicate the nature of investments your business has undertaken in the past 5 years

Vertical integration	
Horizontal integration	
Diversification	
Money market	
Outside agriculture	
Other (Please state)	

7. Has your organisation undergone any of the following restructuring actions in the past 5 years?

Mergers	
Acquisition	
Joint venture	
Conversion to a company	
Strategic alliances	

8. Who motivated such actions?

Members	
Management	
External parties	
Other (please specify)	

9. Rate the following on a scale of 1 to 5 on the decision to convert or restructure? With 1 indicating no role and 5 indicating main role on the decision to convert or restructure.

(a) Members leaving the organisation?

1	2	3	4	5

(b) To raise capital?

1	2	3	4	5

(c) Improve competitiveness of the organisation?

1	2	3	4	5

(d) Relative merits of the company business model?

1	2	3	4	5

(e) Discontent with the performance of the organisation?

1	2	3	4	5

(f) As a strategy to reduce costs?

1	2	3	4	5

(g) Response to the Cooperative Act (Act 14 of 2005)?

1	2	3	4	5

(h) Discontent with the structure of the cooperative?

1	2	3	4	5

(i) Seeking to expand your business empire?

1	2	3	4	5

(j) Members pressure?

1	2	3	4	5

(k) Management pressure?

1	2	3	4	5

(l) Response to the deregulation of the industry?

1	2	3	4	5

(m) Changes in tax laws (1997)?

1	2	3	4	5

(n) Political reasons?

1	2	3	4	5

10. What happened to the number of members of the cooperative after the conversion?

Static ☐ Decrease ☐ Increased ☐

11. (a) What is your BEE score card?

Less that 40% ☐ 40.1 to 64.9% ☐ Greater than 65 ☐

(b) Which area does your organisation need to work on inorder to improve your score card?

Business Ownership	
Employment Equity	
Employment Management	
Skills Development	
Preferential Procurement	
Enterprise Development	
Corporate Social Responsibility	

12. Do you apply triple bottom line accounting reporting on your annual reports?

Yes ☐ No ☐

NB: Triple bottom line accounting is reporting financial information, social information as well as environmental information regarding the business.

13. To what extent do you agree or disagree with each of the following statements regarding your organisational structure?

Strongly disagree 1
Disagree 2
Neutral 3
Agree 4
Strongly Agree 5

	1	2	3	4	5
Organisation structure has not changed for the past 5 years					
The organisation structure is hierarchal					
The organisation is now more networked					
Various other companies or units have been put under one group name					
The organisation has established independent companies or units					

SECTION C: PERFOMANCE INFORMATION

Mark with an X or ✓ (tick) were appropriate

14. How do you finance your major investments?

Bank loans	
Reserved funds	
Issue shares	
New members	
Capital seeking entities (e.g. strategic alliance, a trust company or a publicly held subsidiary)	
Other	

15. How do you rate your staff turnover (specifically management)?

Low ☐ Moderate ☐ High ☐ Very High ☐

16. How has the product mix or services you offer changed in the past 5 years?

Still the same	
Slight changes	
Moderate changes	
Significant changes	

17. Have you made any value addition to the products you handled before?

Yes ☐ No ☐

18. (a) Do you have any performance benchmark for the organisation?

Yes ☐ No ☐

(b) If Yes, who are you benchmarking yourself against?

Leading global businesses	
Other cooperatives	
Local agribusinesses	
Internally generated benchmark	
Other	

19. Do you have enough capital to finance your major investments?

Yes ☐ No ☐

20. Which investors provide the majority of equity for the organisation (rank from the highest to lowest and estimate percentage shareholding)?

	Rank (1 to 3)	Percentage
Members patronising the organisation		
Shareholders		
External investors (including trust companies)		

21. Have your major customers changed over time?

No changes ☐ Slight changes ☐ significant changes ☐

22. (a) Do you distinguish between member and non members as clients?

Yes ☐ No ☐

(b) If Yes, Please state How?

....

....

23. (a) Does your organisation do any special efforts to enhance the efficiency or profitability of its member clients?

Yes ☐ No ☐

(b) Did it create value for the firm?

Yes ☐ No ☐

<u>SECTION D: OWNERSHIP INFORMATION</u>

Mark with an X or ✓ (tick) were appropriate! (If company head straight to question 26, 28 & 31)

24. Which criteria are used to allow new members to join the organisation?

Based on potential patronage that they will bring to the organisation	
Membership is closed	
Restricted to members with the same interest	
Open to anyone with the money to buy shares (public)	
Contribute nominal membership fee	
By invitation	
Other	

25. Have you created different classes of shares to accommodate new investors?

Yes ☐ No ☐

26. (a) How are your shares traded?

Private sells ☐ Publicly offers ☐ Stock exchange ☐

(b). Does the share price fluctuate in value?

Yes ☐ No ☐

27. How do members redeem their equity or shares if they want to exit the organisation?

Get paid their nominal value	
Get paid the market value	
Other (please specify)	

28. How would you describe your dividend policy?

Conservative ☐ Aggressive ☐

29. Do you allow non patron investors in the organisation?

Yes ☐ No ☐

30. What voting principle do you use?

One member one vote	
Based on patronage	
Based on shareholding	
Other	

31. How well attended are shareholder meetings?

Poorly ☐ Average ☐ Well Attended ☐

32. Do you feel that members are sufficiently informed about the organisation in the following areas?

	YES	NO
Major policy decisions		
Operations		
Marketing strategy		
Financial status		
Governance		

SECTION E: MANAGEMENT CULTURE, STYLE, COMPTENCE AND INCENTIVES

Mark with an X or ✓ (tick) were appropriate

33. How best can you describe the management team of your organisation?

Heterogeneous	
Homogeneous	
Autocratic	
Bureaucratic	
Dynamic	
Formal	
Informal relaxed style.	
Focus on transforming people	

34. Do you offer benefit programmes to management in order to enhance performance?

Yes ☐ No ☐

35. What type of incentives do you use to reward management performance?

Share option	
Profit share	
Incentive bonus	
Honorary rewards or non financial recognition	
Other (please state)	

SECTION F: POLICIES OR LEGISLATION

Mark with an X or ✓ (tick) were appropriate

36. Are you happy with the recent Cooperative Act (Act 14 of 2005)?

Yes ☐ No ☐

37. (a) Have you made any response to the Cooperative Act (Act 14 of 2005)?

Yes ☐ No ☐

(b) If Yes, please state what?

…………………………………………………………………………………………………

…………………………………………………………………………………………………

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<u>THANK YOU FOR YOUR TIME AND COOPERATION!!!!!!!!!!!!!</u>