Issues in cross-border mergers between agricultural co-operatives

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A merger between co-operatives involves two mutually dependent merger processes – one concerning the co-operative business firms and the other concerning the co-operative societies, ie, the ownership organisations. If the merger involves co-operatives in different countries, each with its own institutional structure and legal framework, the merger between the co-operative societies is likely to be especially difficult. The driving force behind a merger is the top management teams, and these persons have weak connections to the co-operative societies and limited knowledge about the social networks within the memberships. Hence cross-border mergers between agricultural co-operatives are extremely challenging.

Introduction

Co-operative firms count for a large share of many agricultural markets, including dairy, fruit, wine, and eggs. In the first stage of the value chain, market shares of 70-100% are commonplace. The distinguishing feature of co-operatives is that they are owned jointly by their suppliers or by their customers. These are members of a co-operative society that runs the business activities. Hence, co-operatives constitute a specific form of vertical integration. Without a co-operative as their business partner, farmers would experience high transaction costs because many agricultural markets function imperfectly (Schrader, 1989).

The number of **transnational co-operatives** is steadily increasing in Europe. These co-operatives are co-operative societies with members in two or more countries. Most of these co-operatives are found in Benelux and neighbouring countries as well as in the Nordic countries (van Bekkum and van Dijk, 1997). There are at least three transnational co-operatives in North America (Karlson, 2005). Ocean Spray (cranberries) has members in USA, Canada and Brazil; National Grape Welch in USA and Canada; Calavo (avocado) in California and Mexico. It is possible that transnational co-operatives exist in other parts of the world, as well. There are no statistics specifically about this type of co-operative.

This article is devoted to transnational co-operatives in the field of agriculture, particularly cross-border mergers. The aim of the study is "to identify influencing factors in the process of cross-border mergers between two marketing co-operatives, including the rationales and the background for the mergers". The theoretical foundation of the study is mainly new institutional theories but also literature on strategy and mergers.

The number of cross-border mergers between co-operatives is still very limited (Guilluozo, Perrot and Ruffio, 2005; Guillouzo and Ruffio, 2005). Therefore, it is not possible to empirically verify or disprove any theoretical propositions. Rather, the theoretical accounts are illustrated with examples from the merger between MD Foods and Arla, completed in 2000. This merger between the largest dairy co-operatives in Denmark and Sweden resulted in Arla Foods, which is now the second largest dairy co-operative in Europe. Hence, this merger is also the largest cross-border merger that has taken place so far between agricultural co-operatives.

The data collection was conducted in the summer and autumn of 2004. Personal interviews were made with the chairmen of MD Foods and Arla, the CEOs and other top executives from both co-operatives, in total 20 people.

Cross-Border Mergers Between Agri-Food Co-operatives

Mergers and other modes of creating transnational co-operatives

Transnational co-operatives can be created in different ways: (1) when a national co-operative invites members from another country, (2) through acquisitions in foreign countries, (3) via the establishment of a new co-operative, and (4) as mergers between national co-operatives. There are a number of examples of each of these establishment modes, except for the third one.

(1) By far most transnational co-operatives in Europe have come into being as one co-operative has **recruited members** (suppliers or buyers) in a neighbouring country. Examples are the federated Danish supply co-operative DLA Agro with some members in Sweden, Finland, Norway and the Baltic countries; the Dutch co-operatives AVEBE (starch potatoes) and COVAS (sugar

beets) with German growers as members; Dutch veterinarian supply co-operative AUV with Belgian veterinarians as members; Swedish farm supply co-operative Lantmännen with some Finnish buyers as members (Transnational Co-operatives, 2000).

(2) Another way whereby transnational co-operatives are formed is through **acquisitions**, ie, when a co-operative buys a firm in another country and invites the foreign suppliers to become members. Dutch dairy co-operative Campina has followed this strategy, when buying dairy processors in Belgium (Comelco in 1991) and Germany (Südmilch 1993, Milchwerke Köln-Wuppertal 1997, Emzett 1999, and Strothmann 2003) (De Internationale Coöperatie, 2004, p5). The German dairy co-operative Milchunion Hocheifel attained Belgian and Luxembourgian members after having acquired dairies in these countries (Transnational Co-operatives, 2000).

(3) There seem to be no transnational co-operatives, which are formed after farmers in two (or more) countries have **established a new co-operative society**. This is not surprising because even the number of new national co-operatives is fairly limited. As these normally result in small business firms there is no point in having members in different countries.

(4) **Cross-border mergers between national co-operatives** are quite rare. The prime example is Arla Foods, which is the result of a merger between the largest Danish dairy co-operative MD Foods and the largest Swedish one, Arla. Arla Foods has 10,600 members (almost equally distributed between Denmark and Sweden) supplying 8.4 billion kilograms of milk[1]. Almost 60% of Arla Foods' sales are outside the domestic markets, the UK and Germany being the largest export markets. The turnover is almost 6 billion euros. All figures are from May 2007.

At the time of the merger, both co-operatives had sound financial records. So, this merger must be characterised as an offensive one. Two strong partners wanted to be still stronger. There was, however, also a defensive element because without a merger the two firms might have started to compete intensively in each others' domestic markets.

Another cross-border merger took place when the Danish egg marketing co-operative, Danæg, merged with its Swedish counterpart, Kronägg, in 2004. That merger was clearly unequal – Kronägg was at the brink of bankruptcy, so it was actually rescued by the Danes. Another merger is between the dominating cattle improvement co-operatives in Denmark and Sweden (Dansire and Svensk Avel, respectively) in 2007.

The adoption of the Statute for a European Co-operative Society[2] by the European Council in August 2003 has spurred much interest in transnational co-operatives within the European agrifood industry (Marti and Sánchez, 2006). The rationale behind this Pan-European business form (SCE, Societé Co-operatif Européen) is that co-operatives should be given an opportunity to compete with multinational investor-owned firms (IOFs) in more equal conditions. Considering that today's co-operatives have large and complex business operations, raw product collection and processing in different countries is not a radical step. Many co-operatives have international business operations, selling their products through foreign sales offices. On the other hand, the establishment of transnational co-operative societies is fundamentally different, because members in different countries have different cultures, different production conditions, different legislation (eg, on animal welfare, environmental protection, and taxation), etc.

If more transnational co-operatives are to be established and be competitive in relation to the multinational IOFs, the first three of the above-mentioned establishment options are insufficient. Recruiting foreign members is a slow process; acquisitions often require more capital than the co-operatives have; new establishments result in small operations. The fourth option, on the other hand, may create large, competitive agribusiness firms in a way that is quick and that does not require large investment. Hence, cross-border mergers between agricultural co-operatives can be expected to be a hot topic in the years ahead.

Marketing co-operatives versus supply co-operatives

Except for the distinction between different establishment forms, it is relevant to distinguish between types of co-operative business activities, the main one being supply co-operatives versus marketing co-operatives.

When co-operatives sell farm supplies to their members, eg, fertilisers, seed, diesel and pesticides, the farmer-members' own operations are not affected significantly. The farmers are content if they can get high quality products at low prices, no matter the source, which means that farmers from any country could purchase and even become members. It was an easy decision for Lantmännen (Swedish Farmers´ Supply and Crop Marketing Association) to include Finnish members, or for DLA Argo to accept Swedish members.

In the case of marketing co-operatives, the members are normally more affected by the operations of the co-operative. As the co-operative is to add value and sell the produce of the members, the farmers have to adhere to a set of quality standards and delivery rules. Quite often, the members' yearly proceeds are completely dependent upon the co-operative's way of doing business. Hence, a merger between marketing co-operatives can be expected to be more complex. This article concerns only cross-border mergers between marketing co-operatives.

Number of merger partners

A merger always comprises two partners, but there is in principle no limit as to the number of firms that could be included in a single merger. For example, the formation of Lantmännen in 2001 was a merger between one national co-operative and nine regional ones, all at the same time.

When it comes to cross-border mergers, it is unlikely that the merging partners will be more than two. A cross-border merger between two partners is so problematic that extending the merger to more parties might be extremely difficult. Hence, in the following analyses, only two merging partners are considered.

The co-operative firm and the co-operative society

When two investor-owned firms merge, the decision-makers consider how the business operations can be amalgamated. The stock-holders normally do not have any objections, provided that the resulting firm has opportunities to become more profitable than the merging firms. If the merged firm produces a higher return-on-investment, thus increasing the wealth of the stock-holders, they support the merger, and they are not involved in the post-merger integration process.

A merger between co-operatives is more complicated. "A co-operative consists of a society of (upstream) members and a (downstream) enterprise, whereas a corporation consists of only an enterprise" (Hu, 2007, p11). Hence, a merger involves not only the integration of the business operations of the two societies but also the breaking down of barriers between the members of the two societies and aligning the different ways of thinking within the memberships. It is not only a matter of joining two business firms. The merger is also between two co-operative societies.

The latter merger process may become difficult. According to the most commonly used definition of co-operatives (Dunn, 1988), the members are primarily suppliers, not owners. Their ownership role is subordinate also because the members own the firm collectively. They have limited interest in a traditional co-operative's profits *per se* – their concern is the profits in their own farm enterprises. Hence, they assess their co-operative according to the prices they get for their raw products when selling to the co-operative. The co-operative is most often of immense importance for the revenues that the farmers' get when selling the commodities they produce.

In cases where difficulties with merging the memberships can be expected, there is an intermediary solution, ie, that the two co-operative societies persist but only as owner organisations while the business firms are merged. This solution is, however, not tenable in the long run. The two co-operatives societies will be so intertwined that sooner or later, they will have to merge. The Arla Foods merger is an example of this procedure. The two co-operative societies were amalgamated three years after the merger of the business firms.

A co-operative merger is therefore a double merger. These two mergers are interlinked – a merger between the two co-operative firms presupposes the merger between the two co-operative societies, and the merger between the societies will result in a merger between the firms. Especially, merging the co-operative societies is a complex matter because this organisational type involves not only economic variables but also social ones. For example, the concept of organisational culture has two dimensions. The business firm's culture, including the relations between employees and other stakeholders of the firm, is different from the culture of the co-operative society (**corporate culture and co-operative culture**,

respectively). Likewise governance must be regarded as **corporate governance as well as co-operative governance**. These two perspectives are a challenge in cross-border mergers between co-operatives as compared to mergers between IOFs.

Conditions for Cross-Border Mergers

Co-ordination to overcome heterogeneities

When firms merge there are a number of risks and disadvantages especially in the post-merger integration process (Habeck, Kröger and Träm, 2000). When co-operatives merge, these risks may be expected to be larger because such mergers also involve the merging partners' suppliers or buyers. Even larger consequences may be expected if the merger is cross-border because then the members operate under different circumstances. The difficulties are linked to the concept of heterogeneity – heterogeneity in terms of business activities, logistics, organisational culture, leadership principles, ways of working, and other attributes. The market characteristics of the domestic markets are probably divergent. The institutional conditions, in terms of legislation and governmental structures, will also be different.

The endeavours to integrate the business activities in the new established Arla Foods started immediately after the merger was formally approved. The new management team and the board of directors, together with the various business divisions, started a strategic planning process departing from the stated economic rationales behind the merger. The result was a new common *Strategy 2003* approved by the board in the spring of 2001. For the board and the management to maintain legitimacy in the eyes of the members, the new firm must achieve good results as quickly as possible, so that the promises that were given to the members in the merging process are fulfilled.

When contemplating a cross-border merger, it may be difficult to assess whether the differences can be bridged, and if so, by whom. The probability is high that the decision-makers, being eager to get the merger through, underestimate the difficulties. They may hope that the euro will be introduced as a currency quicker in all EU countries, or that the legislation on animal welfare will soon be harmonised. Provided that the willingness to merge is sufficiently strong among leading persons, such hopes may be unrealistically strong.

For a merger to be successful, both merging partners must be willing to co-ordinate and integrate their activities. The balance may vary depending on the size and strength of the partners. Such adaptations may be quite cumbersome, because they may also involve the slaughtering of 'sacred cows'. So, it is likely that many adaptation measures are not conducted, even though they are highly required, because the merging partners cannot find any compromise. If the parties do not have a willingness to adapt to each other (no 'common glue' according to Morosini, 2004), paralysing conflicts may arise, even to the extent that the aim of the merger is not reached.

Of course, both parties are aware of the fact that such conflicts may follow after the merger. This means that an important part of the merger negotiations concerns how power should be distributed – the composition of the board, the nationality of the chairman and the CEO (Chief Executive Officer), the principles for electing board members, location of the headquarters, the name of the new firm. The merger party that loses these pre-merger fights will also lose many future fights. These issues are in all mergers considered to be 'deal-breakers'.

In the Arla Foods case especially the location of the headquarters might have been a deal-breaker, since it was decided that MD Foods' headquarters in Aarhus should also be the new headquarters.

> That was certainly a mistake but at that time it was too big a risk moving the headquarters to eg Copenhagen

said a former CEO, and the other one agreed in an interview. A few years after the merger, Arla Foods' staff has become strongly dominated by Danes. Only few Swedes work at the headquarters, because Aarhus is too far away from Sweden and because so few other Swedes work there.

A location in the Copenhagen area, within commuting distance of Sweden, would probably have resulted in a more balanced staff. One may claim that the nationality of the staff should not be of importance – each person should act in a cosmopolitan way. On the other hand, a staff with mixed nationalities might work less efficiently due to the risk of misunderstandings and conflicts. It is unclear to what extent

employees of one nationality have difficulties servicing people of another nationality well. At least there is no evidence that the Danish dominance in Arla Foods has caused any problems for the Swedish members.

The location of the headquarters seems to have been one of the deal-breakers also in the collapsed merger negotiations between Arla Foods and the Dutch dairy co-operative Campina in early 2005. The Danish board members could hardly accept any other solution than the existing one, while the Swedish directors preferred Copenhagen. Moreover, the Dutch objected to Aarhus. In the early announcement of the plan to merge the two parties, Copenhagen was declared the location of the headquarters. This event indicates the strategic importance of the headquarter location.

It is likely that transnational co-operatives introduce more **politics** in their by-laws than national co-operatives do. Such paragraphs will not promote the economic records of the firm. If, according to the agreement, the CEO and the board chairman must have a specific nationality, the appointed persons may not be the very best ones. Certain issues are perhaps not discussed because they may harm the power balance, even though these issues may have large cost effects, eg, moving a certain production line from one country to the other. Some evidently efficiency-hampering rules may be upheld, for example that the members in one country should have a higher pay than members in the other country. Those political matters may create conflicts because there is no objective way of deciding what is right or wrong – if only economic factors were ruling, it is easier to calculate the financial effects of a decision.

Political factors become important especially because a merger proposal can be expected to be met with suspicion and resistance by a large share of the membership. Following a merger, the often conservative farmers may face new business routines and other changes in their daily operations. So, in order to calm the waves within the memberships, the negotiations between the power-holders may result in more political rules than are economically justified, ie, rules that do not create the strongest possible business firm.

For a merger between co-operatives to be initiated and to develop well, the advantages must outnumber the disadvantages, as subjectively perceived by the decision-makers – top-level people as well as rank-and-file members (Vandeburg, Fulton, Hine and McNamara, 2000). Because the aim of a co-operative is to promote the economic interests of its members, the ultimate criterion is if the new co-operative is stronger than each of the merging partners. Further, it is interesting to identify factors that indicate whether the merger will be successful. Such factors are of different kinds – the accounts below distinguish between economic and social factors, pertaining mainly to the co-operative firms and the co-operative societies, respectively.

The economic rationales behind co-operative mergers

Co-operatives exist for the sake of ameliorating various kinds of market imperfections, which the members would experience if they did not have the co-operative (Schrader, 1989). If the merger is to be approved by the memberships, a qualified majority of members of both co-operatives must be convinced that the new co-operative can be more valuable to them than the existing ones. The members' main interest is the price that they get for the agricultural produce when selling it to their co-operative or to other processing firms. The members do not care about how the market value of the co-operative is affected by an eventual merger, since the shares that the members own in the co-operative are not tradable and appreciable. The members have invested small amounts in their co-operative but large amounts in their own farming operations, and their involvement in the co-operative is contingent upon the co-operative being an instrument for them in their farming businesses.

The farmers in both merging partners must believe in **a higher relative price level**, if they are to approve of the merger. Sometimes a Pareto optimal solution is imaginable, implying that one membership gains so much that it is willing to subsidise the other membership. In the Arla Foods case it was agreed that the Swedish members would get a higher price for their milk in the first couple of years after the merger, because the Swedish milk price was higher than the Danish one prior to the merger. After three years the prices were fully harmonised. It is evident that such differentiated prices foster inefficiency within the co-operative, but at the time of the merger, this was a political necessity – the Danish dairy farmers subsidised the Swedish ones, otherwise the merger might not have been realised.

The literature presents many ways of

classifying members' motives for being members, or the role that a co-operative may have for its members (Cook, 1997; van Dijk, 1997). One role is that a co-operative, being organised according to traditional co-operative principles, may increase the volume of processing operations more than any other organisational type (Nilsson, 1998). The raison-d'être of such a co-operative is the lowest possible average cost level, which means that the farmers may get a higher price for the produce they sell to the co-operative than they could get from any other processor.

A cross-border merger could be a way to increase the scale of operations, whereby the cost per unit of processed goods falls. There are many types of costs that can be reduced by increasing size, all of which are in accordance with the traditional arguments for horizontal mergers (Sudersanam, 2003):

- Production costs (larger production plants and better capacity utilisation).
- Product development costs (more new products and more innovative products).
- Market influence costs (it is possible to satisfy the needs of the largest buyers).
- Financial costs (lower investments per unit; better borrowing conditions) (Richards and Manfredo, 2003).
- Marketing costs (lower investments and better market impact if the market size increases).
- Administrative costs (lower overhead per unit, and more skilled staff).
- Procurement costs (larger scale of procurement of packaging materials, additives, etc).

Hence, cross-border mergers between co-operatives are more likely if the co-operatives operate in small countries because these countries' small domestic markets make it difficult to reap sufficient **economies of scale**, even though the co-operatives operate nationwide. Alternatively, the merging partner can be expected to be located in larger countries where the competition authorities object to nationwide co-operative societies (for instance Germany).

While the above-mentioned rationale for co-operatives is based on a combination of neo-classical economic theory and game theory, another approach has transaction costs as the basis. The transactions concern the product flows from the farmer to the co-operative, and then further to the sales markets. To the extent that the farmers experience high transaction costs in their relations to independent buyers, they may benefit by jointly integrating forward in the value chain. Having control over at least part of the value chain, the farmers can avoid being caught in a hold-up situation, ie, exploited by fraudulent buyers.

Moreover, **economies of scope** may be important. While economies of scale presupposes that the members of the merging co-operative societies supply the same product to the co-operative, economies of scope may follow if the members produce different types of produce. An example is the British co-operative Anglian Produce, which prolongs the season for fresh supplies to retail chains by having a few Spanish potato growers as members (van Bekkum and van Dijk, 1997, p164). Hence, the co-operative can get better prices, whereby the farmers' prices also increase.

Facilitating and inhibiting factors – economic ones

There are innumerable factors to explain why a cross-border merger between co-operatives will be initiated and be successful, ie, whether a large majority of the memberships as well as the management and the board find that the members' profitability will be improved (Ringle and Keebingate, 2001). Some of the factors that affect the business operations of the co-operative firm are as follows:

1. Co-ordination and integration becomes easier if **one of the merging partners is much stronger** than the other one, whereby the strong partner dictates the conditions and the weaker partner has to comply. Moreover, the initiative to merge a strong and a weak partner can easily come up – if the weak partner's option is a disaster, it is better to join with a strong one, no matter the conditions. Throughout co-operative history there have been numerous examples of such enforced mergers, not the least in MD Foods' history (Søgaard, 1990).
2. If the merging partners are located in **neighbouring countries***,* it is expected to be easier to obtain co-ordination in production, transportation, and marketing.
3. A merger is more probable if the merging partners' domestic countries have **similarities in various political and**

institutional respects (taxation, production regulations, etc). The Arla Foods merger was, however, conducted in spite of a number of dissimilarities: (a) Even though Arla Foods would pay exactly the same milk price to all members, the Danish and Swedish farmers get different amounts after tax. (b) Both countries have their own currencies, and the exchange rate fluctuates every single day.

4. Integration becomes easier if the merging partners have **experience from many previous mergers**, especially if these experiences are good. Because Arla and MD Foods were dominant in their domestic markets, it is easily understood that both of them were the result from numerous previous mergers (Utterström, 1980; Søgaard, 1993).
5. In situations where the **market conditions are turbulent**, there are more gains to be reaped from a merger, even a cross-border one. This concerns both sales market (the retail and the consumer markets) and input markets (the members' production conditions). A large firm is expected to be better equipped to meet such challenges. This was a main argument for creating Arla Foods. It could be a countervailing power in relation to the retail industry that is more and more dominated by huge multinational retail chains.
6. If a merger is to have a good chance of becoming successful, the merging co-operatives should not be very different in terms of financial status, financial instruments, market strategies, and many other **strategic business factors**. Large divergences may create problems in reaching agreements about the future strategy and policies. Although MD Foods was larger and more experienced in the export markets, the Arla Foods merger was communicated to the members of both co-operatives as "a merger between equals", though it was not clearly spelled out what this might mean. It is probable that the management and the board could easier get the members' support for merger, if they stress "merger between equals", no matter the actual power balance. Therefore neither membership will feel a loser. However, if both merging parties in an imbalanced power relation consider themselves to have equal power, conflicts are likely to evolve.
7. Co-ordination could become easier if the two partners are similar in terms of business operations, in that different production lines in the two countries can be merged and cost savings can be achieved. This applies if the merger motive is the attainment of lower costs. A risk is, however, that similar business activities may cause conflicts as the two partners may fight over whether production should take place in one country or the other. Cost savings in production, procurement, marketing and administration was essential for the Arla Foods merger, including a plan to close down half of the production sites and at the same time invest in new production facilities both in Sweden and in Denmark. However, cost savings are not sufficient for success in the long run. Resources and competence(s) also have to be transferred between the merging partners to enhance revenues and the ways of working (Sudarsanam, 2003).
8. There may also be gains if the two partners have somewhat **dissimilar business operations**, so that both partners realise that economies of scope can be harvested. MD Foods had a strong position in many foreign markets but it had insufficient capital to exploit the market opportunities while Arla worked mainly domestically though with a strong financial status. Very different business operations may result in conflicts as one partner may want to keep the other partner out of 'its own' businesses.
9. If a merger proposal is to have a good chance of being approved by the members, it should be launched at a time when the merging co-operatives expect favourable market conditions in the years to come. The members will be unable to judge whether a good milk price depends on the co-operative being successful or whether the business cycle is rising. A few years after the merger of Arla Foods, the market conditions worsened, so the management had a challenge to explain to the members that the milk price would have dropped even more, had the merger not taken place. Immediately after the merger, the business conditions were bright, and so, the members were satisfied with the merger. It was an 'early win' (Habeck et al, 2000).

Facilitating and inhibiting factors – social ones

A large number of social variables can be identified, all of which may affect whether a cross-border merger is initiated and conducted

and whether the outcome is successful. Some examples are:

1. A merger is more probable if the partners are located in countries with **similarities in various cultural respects** (eg language, business mentality). Although there are similarities between the Swedish and the Danish culture, there are also differences.
2. After a merger there is **only one CEO** instead of two, only one board, etc. It is probably important if the CEO in at least one of the merging partners is close to retirement.
3. A CEO who has worked in the co-operative for an extended period of time and who has been successful may have better possibilities of convincing the directors of a merger proposal. **Seniority** fosters trust.
4. Like in most cases when radical changes are to take place, there is a need for a **'strong man'** – a person who considers the change to be important, who is in a power position, and who is willing to take risks. In the Arla Foods case two strong men joined forces – the CEOs of the merging firms, both very experienced in national mergers.
5. So-called **'personal chemistry'** is important, especially when the agreements may have far-reaching consequences. For a cross-border merger to be initiated and to proceed, at least the CEOs must have trust in and sympathies for each other. This was the case in the Arla Foods merger, where the two CEOs have known each other for many years, and over the years have discussed the advantages of a merger.
6. Depending on a host of circumstances, the members of a co-operative have different options for expressing dissatisfaction. In large and heterogeneous co-operative societies, the members have difficulties using the **'voice option'** – the individual's opinion is drowned. In the case of a business activity characterised by extreme economies of scale, whereby the industry will consist of one single buyer, the farmers will have difficulties making use of their **exit option** – there is just simply no other to buy their produce. In both situations, the power-holders in the co-operative (the CEO and the board) will have better chances of completing a merger.
7. Where the members of a co-operative have economic difficulties in their farming operations, it is more likely that they will take a positive stance in relation to a merger proposal. The present co-operative has failed to serve them properly, so they tend to resort to a new, merged co-operative. In 1999/2000 when the Arla Foods merger proposal was presented, increasing competition caused the milk prices to fall in both countries, which may have spurred the dairy farmers to support the merger.

The Merger Process

The role of management

National mergers between co-operatives are commonplace. Thousands have taken place over the decades as a result of the members wanting to save costs and become competitive through economies of scale, including gaining market strength. Such mergers have not been very dramatic. Farmers have social networks, even though they patronise different co-operatives. Living in the same country they have the same market conditions, the same cultural background, and most often the same language. Hence, it is no wonder that domestic mergers take place frequently and are conducted easily in most cases (Utterström, 1980).

When it comes to cross-border mergers, the situation is different. Farmers in different countries do not have social interchange. The farming conditions are dissimilar. Often there are different cultures and languages. All this means that the initiative for a cross-border merger is not likely to come from the grassroots. Most rank-and-file members take a passive position in relation to their co-operative. Individual members have no incentive to promote a change for the entirety of the co-operative society. They would be stupid if they were to spend their personal resources on a cause that might benefit the collective (Olson, 1965).

The initiative is more likely to originate from the management, especially the CEO. Top management often meets with foreign colleagues at conferences or meetings. The CEO is the one who is best informed about how market trends evolve, how competition changes, how cost levels develop, and other factual matters, and the CEO has the best network of contacts. The CEO also has strong motives – it is more gratifying to be the CEO of a large firm than a small one, ie, the power increases, the reputation is strengthened and the salary may become higher.

The Arla Foods merger was clearly driven by the two CEOs but also the two chairmen were convinced already in an early stage of the merger process. One factor that decides management's power in relation to the board is the financial status. A co-operative where the amount of unallocated (collectively owned) equity far exceeds the amount of allocated (individualised) equity, is likely to have a membership that does not worry about property rights. The so-called **vaguely defined property rights** of such a co-operative will create agency problems, ie, the principal has difficulty controlling the agent (Cook and Iliopoulos, 2000). The managements had much control in Arla as well as in MD Foods, both of which had almost all equity capital as unallocated.

Another factor would be the size of the co-operative as well as the complexity of its business activities. No matter how qualified the directors (and the members) are, the business operations could be so comprehensive and so complex that directors and members have difficulties grasping them. Hence, the agency problems become even more pronounced. Both Arla and MD Foods were, prior to the merger, among the largest dairy co-operatives in Europe, and both had integrated very much downstream.

In the literature on co-operatives, there is a long-standing discussion about the power relations in co-operatives. Most researchers consider the CEO to be more powerful than the board of directors. The CEO is the expert, while the board consists of more or less laymen, seeking support and advice from the CEO. According to agency theory, this may bring problems as the agent is in control, not the principal, ie, the membership. On the other hand, the opposite view is also heard, ie, that the membership benefits from a powerful CEO in co-operatives (Hendrikse, 2007). In the context of a traditional co-operative the agency relations are specific. The fact that the management is in power does not necessarily mean that the membership will suffer – the outcome could be just the opposite (Steger and Kummer, 2004).

Where the members have little or no individual ownership in the co-operative, they have no reason to consider whether the co-operative will increase its value as a consequence of a merger. The members care about the price that the co-operative pays for their raw products, and therefore the value of their own farm enterprise. The members have in principle an incentive to drain the co-operative of its equity – they would like to get prices higher than the co-operative is able to pay. Managers, on the other hand, have an interest in showing the business world that they are qualified as business leaders, so that they have a chance of advancing to a better position. Hence, management may have a more long-term perspective on the business activities than members. Moreover, board members may apply a long-term perspective in their decision-making.

Co-operatives are often considered more risk-averse than IOFs, one reason being that co-operatives have a so-called double screening procedure (Hendrikse, 2007; Hu, 2007; van der Krogt, Nilsson and Høst, 2007). The management of an IOF has the right to make most decisions autonomously, while the board of a co-operative involves itself heavily in many strategic issues and major business decisions. This should be linked to the fact that the owners of a co-operative are not primarily owners but patrons to the firm, whereby they become much affected by the co-operative's business operations.

An implication of this is that the CEO, having identified a cross-border merger possibility, must make sure that the board unanimously supports him. If the board is not united, it is next to impossible to convince the members. Further, it may be that the directors, when communicating with the membership, use the arguments, presented by the management. Hence, the directors may function as the management's elongated arm. Even though the directors are principals for the agent, ie the CEO, they may act as if the relationship were the opposite.

The role of the memberships

Provided that the management is stronger than the board, one would expect the merger process to have a focus on integrating the business organisations, with a weaker focus on the integration of the membership organisations. Management is responsible for and knowledgeable about the business operations, while managers have limited opportunities to influence the members. Second, the formal relation is clear – the members are the principal and the managers are the agents. Third, if the members' voice option is weak, the management might consider the exit option more important. Hence, by integrating the various business activities into an efficient body,

the co-operative is able to pay the members better prices, thereby gaining support from the members.

The management in both Arla and MD Foods were well aware that integrating the firms is easier than integrating the societies. By putting considerable effort into gaining confidence from the members, they attempted to influence members to become more supportive to the new firm. This was not an easy task – a special challenge was to explain to the members the need to close several production sites, perhaps in their own backyard.

When CEOs want their co-operative to merge with another co-operative, they must first of all convince the boards of directors. As a board consists of farmer-members, and the directors regularly meet rank-and-file members at meetings, as neighbours, and in many other forums, the directors assess the merger proposition according to the same criteria as the members do, ie, whether an eventual merger might improve the co-operative's ability to pay a high price for the raw products. If the CEOs can convince the boards of this, the directors' next task is to inform the memberships, and this campaign will have the same theme – the price benefits from the merger.

Before the Board of Representatives approved the Arla Foods merger, there was a 'road-show' to numerous local membership forums, where the advantages of the merger were presented. The main argument was that without the merger the milk price would be threatened.

As soon as the board announces a merger proposal, social forces are set into motion, especially if it concerns a cross-border merger. The members have more questions than anybody can answer, and the members require clear answers. The core concept is credibility. The members must have faith in their elected representatives, even though these are not able to provide good enough information.

In the frustration that follows this information campaign, it is likely that both the CEO and the directors want the process to be as quick as possible. The more time that the members can devote to analyses and contemplation, the higher is the risk that a wave of resistance will arise.

When a merger between co-operatives is announced, no help can be expected from any qualified analysts because the shares are not listed at any stock exchange. Mass media do not report much, and financial analysts have neither any interest in the merger, nor any opportunities to conduct analyses. All information about the proposed merger originates from the co-operatives involved. That is to say that the members get no impartial information. Furthermore, the information originates from the staff at the co-operative firm. Hence, most of the information is about how the merging co-operative firms should be integrated, while little concerns the integration of the merging co-operative societies.

The role of the Board of Directors

The difficulties of harmonising co-operative societies are aggravated if there is poor harmonisation also within the board of directors. If there are conflicts between board members of different nationalities one cannot expect the memberships to share the same opinions. Moreover the opposite relation holds true, ie, if there are significant differences between the memberships, there will probably be similar differences between the elected representatives. In other words, vicious circles come into operation.

The divergences between the memberships and between the directors of different nationalities may be due to culture, and so in different contexts – national as well as organisational culture. The organisational culture is also dependent on the history of the firm, the institutional environment, and the degree of and type of business operations. The board of directors in Arla used to discuss mainly strategic issues and membership issues, while the board in MD Foods was also very concerned about details in the business operations.

In connection with the collapsed merger discussions between Arla Foods and Campina, mass media reported Danish-Swedish conflicts within the Arla Foods' board. The Swedish directors were positive to the merger, while at least some of the Danes were sceptical.

If the merger with Campina had been conducted, there would also be other effects, which the Danish directors might have found disagreeable. One would be a threat to the present Danish dominance in Arla Foods – the CEO, the chairman and the board majority.

Conclusions

This study identifies a large number of factors that influence the process of cross-border mergers between marketing co-operatives, and

also some inhibiting factors. The most decisive factor seems to be the role of the CEO.

CEOs, no matter what kind of firm, have superior knowledge of the firm, compared to the owners of the firm (Cook and Iliopoulos, 2000). Moreover, according to agency theory, the CEOs have different interests from the owners. In a co-operative context, the power relation may be expected to be more imbalanced than it is for investor-owned firms because the collective ownership reduces the members' motivation to conduct a strict control of the management.

Against this background, it is understandable that the initiative to conduct a merger between co-operatives is likely to come from the CEO and not from the board of directors. This is especially so when the merger concerns co-operatives in different countries as such a merger is very complex. CEOs of larger firms often receive a higher salary, more prestige and better career prospects. Due to the information asymmetry, CEOs have a relatively good opportunity to convince the board of directors of the desirability of such a cross-border merger.

However, the CEOs' knowledge primarily concerns the business operations. Hence, they are able to plan how the two co-operative firms can harmonise the operations but less how the co-operatives societies can be integrated.

A practical implication of this study is that in a cross-border merger between co-operatives, the decision-makers should focus on the co-operative societies just as much as the co-operative business firms. If the memberships are not integrated, the merger is doomed to have problems.

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Notes

1 http://www.arlafoods.com/
2 http://europa.eu.int/comm/enterprise/entrepreneurship/coop/statutes/statutes-coop.htm