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by

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Mergers--What to Look For, When Should We Study,
What Signals a Potential Merger

At the 1985 National Institute of Cooperative Education at Kansas State University, we saw evidence of a major shift in cooperative strategies and philosophy. Cooperative management and board of director members presented a consistent perspective on cooperatives and agriculture. Agriculture and agribusiness were protrayed as having burdensome excess capacity in the 1980's rather than being the dynamic growth industry of the 1970's. Instead of debating how to allocate net savings, the debate centered on the appropriate method for allocating losses. Instead of agrueing whether cooperatives should have positive returns to their patron-investor's investment, the resounding theme was that cooperatives must have positive net savings. These positive net savings are essential if cooperatives are even going to survive as a viable competitor in the domestic and international markets.

But these coooperative concerns are trivial compared to what I consider to be the "REAL" issue. The "REAL" issue is whether cooperatives, as business organizations have the strategic flexibility to adapt to rapidly changing business climates. Do cooperatives have the ability to "reposition themselves in a market, change their game plans or dismantle their strategies when the customers they serve are not as attractive as they once were (Harrigan, pp.1)?"

The market system has never been an easy task master. However, the increased rate of change in our business environment has increased the brutality of the market system. Any cooperative management or board of directors making business decisions, which reduce the strategic flexibility of their cooperative, endanger its viability. The market system's retribution will bloody the cooperative to within an inch of its life in the matter of months not years.

Be an Environmentalist

To compete in a changing business environment, cooperative boards of directors and management must be good environmentalists. The environment is all the circumstances, conditions and influences that affects either organisms or its surroundings. A environmentalist is a person working to solve environmental problems. As many of you know "they" are very sensitive to change and very aggressive in the pursuit of their long-term objectives. To be effective they must be externally oriented.

Cooperative boards of directors and management must be sensitive to changes beyond the day-to-day operations of the cooperative. Attention must be directed toward some of the following questions:

A. What are the competitive threats and opportunities WITHIN and OUTSIDE the cooperative's traditional trade area?

B. How is the cooperative's current and potential customer base CHANGING and will the cooperative be able to PROFITABLY serve their needs in five years?

C. How will changes in INFORMATION and MARKETING technologies affect the cooperative's ability to compete?

These types of questions must be asked and answered (Turner, pp.12-13). Board of directors and management time must be directed towards this issue. Mergers are just one possible organizational response if the answers to these questions indicate a deterioration in the cooperative's competitive position.

Invest or Get Out

Man has never been satisfied with just living in the environment. We have made major strides in altering the environment to suit human needs. A cooperative business with sufficient strategic flexibility can exist in a declining industry if the environmental conditions are correct. However, some business environments are so hostile and the cooperative is so out of strategic position, that the best option is exit.

Harrington has recently outlined the environmental characteristics that determine whether a business should increase investment or get out (see Figure 1). Let us look at this list for implications for cooperatives by concentrating on the hostile environment. This hostile environment in many ways summarizes the strategic position of many cooperatives.

1. DEMAND-PRICE SENSITIVE: Many of the commodities and services provided by cooperatives are very price sensitive. For example, price is a major factor in producer grain marketing decisions. The cooperative must have a cost structure and market outlets that makes the cooperative competitive.

2. DEMAND COULD DETERIORATE RAPIDLY: Government intervention such as PIK can cause a severe short-term decline in the demand for pesticides. However, the real danger for cooperatives here is excessive dependence on a limited number of patron-investors. If these patron-investors shift to a competing firm, the cooperative can suffer a major deterioration in competitive position. Also, if a cooperative is utilizing antiquated technology, a competing firm may be able to "blow" the cooperative out of the market by introducing the new technology.

3. CONSUMERS HAVE LOW SWITCHING COSTS: Increasingly, cooperatives have to deal with decreasing patron-investor loyality. If a number of competitors can deliver the product, the switching costs are relatively low if the cooperative competes primarily on a price basis. If products offer superior performance for their price or the cooperative is the only viable competitor, these costs increase the producer's switching costs.

4. COMPETITION IS USUALLY VOLATILE: Are the products handled by the cooperative subject to unpredictable competition? Is it easy for firms to enter the industry and is it easy for them to exit the industry? For example, independent truckers or farmers entering the trucking business represent a major source of competitive instability for grain elevators, which depend on trucks to merchandise their grain.

5. COMPETITORS HAVE HIGH EXIT BARRIERS: In this area cooperatives are probably their own worst enemy. Cooperatives have a real problems exiting from a market because of their traditional stress on service even at unprofitable levels. Other issues include community responsibilities, patron-investor resistance to the reorganizational efforts, previous internal political battles,

Figure 1: Environmental Traits That Affect the "Stay In" Versus "Get Out" Decision

Aggressive (Increased Investment Strategy)	<=======================================> Cut Losses (Get-Out-Now Strategy)
1. Demand-price insensitive	Demand-price sensitive
2. Replacement units likely to be by some customers for a long time	Demand could deteriorate abruptly
3. Loyal customer demand likely to endure	Low customer switching costs
4. Revitalization likely, although remote	Competition usually volatile
5. Cooperative serves protected (high entry barriers) market niche alone.	Competitors face high exit barriers
6. Suppliers willing to help firm compete.	Customers likely to exert bargaining power

Source: Kathryn R. Harrigan, Strategic Flexibility: A Management Guide for Changing Times, p. 115.

and management resistance to making employee cuts (Swanson, 14-16). However, it is important to note that many of these barriers to exit also affect investor-owned firms.

6. CUSTOMERS LIKELY TO EXERT BARGAINING POWER: Patron-investors are either large enough or have enough competitive options to negotiate favorable treatment to point where profitability of of the cooperative suffers. Also, patron-investors threaten to discontinue their business with the cooperative if the cooperative attempts to terminate unprofitable services.

These characteristics may differ greatly among the products and services provided by the cooperative.

What Is Required to Survive?

A cooperative can survive in such a hostile environment if it has a number of the following characteristics:

1. Cooperative has strong and durable relationships with customers in a number of product markets.

2. The cooperative's physical plant can be operated efficiently relative to its competitors, when operated at less than full capacity.

3. The cooperative has a strong distribution and marketing network, which allows the cooperative to maintain a competitive advantage.

4. The cooperative has a highly valued brand name with strong customer loyality and superior performance.

5. The cooperative has a favorable location(s) and has an aggressive procurement program to obtain lower input prices.

6. The cooperative has assets in the industry that are heavily depreciated or acquired at distressed prices or have alternative uses so exit is possible.

7. The cooperative has been able to diversify itself in terms of products offered, customers and locations.

Notice these strengths move the cooperative towards being more capable to operate effectively in a hostile environment (Harringan, pp.114-115). A merger may enable the cooperative to increase its strengths.

Mergers Are Just One Option

Institutional innovation is a necessary requirement if we are going to adapt to our changing environment. Problems in attempting to merger two or more cooperatives are all too well known. If a merger is not feasable, some intermediate step may be feasable. Current antitrust laws provide cooperatives considerably more flexibility in devising cooperative agreements than investor-owned businesses.

For example, a local grain marketing cooperative identifies that they have a profitable feed business. However, their lack of rail service and inability to use unit car rates results in their grain merchandising facility being underutilized. The cooperative identifies larger cooperative unit train facility and negotiates an agreement to obtain favorable price treatment if certain volumes are merchandised. The larger cooperative may be interested from the strategic perspective. First, to obtain additional grain to improve the utilization of their facilities. Second, to establish a market presence so as to discourage the entry of a less cooperative competitor.

Do not be afraid of being creative. Identify your cooperative's strategic position and do something about it. The window of opportunity may be open only briefly. Local cooperatives that are profitable and have strategic flexibility will survive. Agriculture and agribusiness are going through a major restructuring and capacity reduction. The past will not be the future.

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