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Cross-border Mergers Between Agricultural Co-operatives - a Governance Perspective

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Abstract
A merger between agricultural co-operatives involves two merger processes – one concerning the two co-operative business firms and the other concerning the two co-operative societies, i.e., the ownership organisations. These two merger processes are mutually dependent. If a merger involves co-operatives in different countries, each with its own institutional structures, farming conditions, legal framework, and other attributes, the merger between the co-operative societies is due to be difficult, requiring large efforts to attain the necessary degree of homogeneity. At the same time it must be recognised that the driving force behind a cross-border merger is the top management teams of the co-operatives, and these persons have only weak connections to the co-operative societies, and limited knowledge about the social networks within the memberships. These observations imply that there are some challenges to cross-border mergers between agricultural co-operatives.

Key words
Co-operative, agriculture, agribusiness, merger, cross-border, transnational, governance

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Contents

1. Introduction

Co-operative firms count for a large share of many agricultural markets – dairy, fruits, wine, eggs, etc. 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, the farmers would experience high transaction costs as many agricultural markets function imperfectly.

The number of *transnational co-operatives* is steadily increasing in Europe. This concept stands for 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 (Agricultural …, 1997). There are at least three transnational co-operatives in North America (Karlson 2004). 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 is 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 factors that may make cross-border mergers between agricultural co-operatives possible and that may make the mergers successful from a governance perspective.* This is done through theoretical analyses, using mainly new institutional theories but also literature on strategy and mergers.

As the number of cross-border mergers between co-operatives is still very limited, it is not possible to empirically verify or falsify any theoretical propositions. Rather, the theoretical accounts are illustrated with examples from the merger between MD Foods and Arla, completed in the year 2000. This merger between the largest dairy co-operatives in Denmark and in Sweden resulted in Arla Foods, the largest dairy co-operative in Europe and the second largest in the world, next to Dairy Farmers of America. 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 semi-structured interviews were made with the two chairmen, the CEOs and other top executives from both Arla and MD Foods, in total 20 persons. The length of the interviews was most often 1-2 hours. All interviews were tape recorded. The main issues covered in the interviews were the post-merger integration process. Other information was obtained through publicly available information as well as confidential documents about the merger process.

There is some literature on mergers between co-operatives (Utterström, 1980; Ringle & Keebingate, 2001; Vandeburg et al., 2001; Richards & Manfredo, 2003), and many researchers have conducted studies on strategic issues of agricultural co-operatives as well as internationalisation of such firms (for example Hedberg, 2004; Guillouzo and Ruffio, 2005; Guillouzo et al., 2005; van der Krogt, in press). However, no researcher, not even in the countries where transnational co-operatives are operating, seems to have investigated mergers between co-operatives in different countries.

The article is organised as follows. The next section discusses the main issues in cross-border mergers between agrifood co-operatives, thereby adding some details to the research question.

Then follows a section that aims at identifying factors that may be decisive for whether a merger is initiated and whether a merger may become successful. Next follow some propositions about the merger process – how this process may be proceeding, who may be expected to take action, the reactions to the merger proposal, etc. Finally conclusions and some implications are presented.

2. 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 Den Lokale Andel (DLA) with some Swedish member co-operatives; 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 Norrbottens Lantmän with some Finnish buyers as members (Transnational …, 2000).

(2) Another way whereby transnational co-operatives are formed is through *acquisitions,* i.e., 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, Strothmann 2003) (De internationale …, 2004, p 5). The German dairy co-operative Milchunion Hocheifel got Belgian and Luxembourgian members after having acquired dairies in these countries (Transnational …, 2000).

(3) To the knowledge of the authors, there are no examples of transnational co-operatives, which are formed after farmers in two (or more) countries have *established a new co-operative society.* This is not surprising as also 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 13,600 members (7,100 in Denmark and 6,500 in Sweden), supplying 8.5 billions kilograms of milk[1]. Almost 60% of Arla Foods' sales is outside the domestic markets, the U.K and Germany being the largest export markets. The turnover is 5.3 billion euros. All figures are from January 2004. At the time of the merger, both co-operatives had sound financial records. This merger must be characterised as an offensive one. Two strong partners wanted to be still stronger. There was,

[1] http://www.arlafoods.com/

however, also a defensive element because without a merger the two firms might have started to compete at each others' domestic markets, like they did up till 1995.

During the Winter 2004/2005 there have been merger negotiations between Arla Foods and Dutch/German/Belgian Campina, but the two parties didn't succeed to agree on a joint position. As hardly any information about these merger discussions is yet revealed this case is not analysed in this study.

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 of defensive and unequal character – Kronägg was at the brink of bankruptcy, so it was actually rescued by the Danes. In September 2005, Swedish media reported about two eventual mergers. There are speculations about a merger between the largest Finnish dairy co-operative, Valio, and the second largest Swedish one, Milko. The dominating cattle improvement co-operatives in Denmark and Sweden (Dansire and Svensk Avel, respectively) are planning to merge.

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. The rationale behind this Pan-European business form (SCE, Societé Co-operatif Européen) is that co-operatives should be given a possibility to compete with multinational investor-owned firms (IOFs) at 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, as members in different countries have different cultures, different production conditions, different legislation (e.g., on animal welfare, environmental protection, and taxation), etc.

If more transnational co-operatives should 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 require most often more capital than the co-operatives have; new establishments result in just 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 investments. Hence, cross-border merger between agricultural co-operatives can be expected to be a hot topic in the years ahead.

Marketing co-operatives vs. 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 are selling supplies to their members, e.g., 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, not matter the source, which means that farmers from any country could purchase and even become members. It was an easy decision for Norrbottens Lantmän to take in Finnish members or for Den Lokale Andel to accept Swedish members.

[2] http://europa.eu.int/comm/enterprise/entrepreneurship/coop/statutes/statutes-coop.htm

In case of marketing co-operatives, the members are normally much 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 one single merger. For example, the formation of Svenska Lantmännen (Swedish Farmers´ Supply and Crop Marketing Association) 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 are 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 firms can be amalgamated. The share-holders do normally 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 share-holders, they support the merger, and they are not involved in the post-merger integration process.

In the co-operative case, it is not only a matter of joining two business firms. The merger is also between two co-operative societies, each of which owns a business firm. A co-operative society is an organisation for collective ownership of a business firm. Hence, not only should two firms become one – also two co-operative societies should be turned into one. The latter merging process may become difficult. The members are primarily suppliers, now owners. Their ownership role is also subordinate as they own the firm collectively. They are not interested in the business firm's return-on-investment *per se* – their concern is the return-on-investments in their own farm enterprise. 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 to the members as a source of income.

In cases where difficulties with merging the memberships can be expected, there is an intermediary solution, i.e., 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 as this organisational type involves not only economic variables but also social dimensions. For example, the concept of organisational culture gets two dimensions as the business firm's culture, comprising the relations between employees and other stakeholders of the firm, should be separated from the culture of the co-operative society (*corporate culture* and *co-operative culture,* respectively), and governance must be regarded as *corporate governance* as well as *co-operative governance.* These two governance perspectives are a challenge in cross-border mergers between co-operatives as compared to mergers between IOFs.

3. Conditions for cross-border mergers

Co-ordination to overcome heterogeneities

When firms are merging there are a number of risks and disadvantages especially in the post-merger integration process (Habeck et al., 2000). When co-operatives are merging, these risks may be expected to be larger, as such mergers involve also the merging partners' suppliers or buyers. Even larger consequences may be expected if it concerns a cross-border merger 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 etc. The market characteristics on the domestic markets are probably divergent. The institutional conditions, in terms of legislation and governmental structures, are due to be different.

The endeavours to integrate the business activities in the new established Arla Foods started immediately after the merger was formally approved of. 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.

Hence, following a merger, the need for co-ordination and integration is large. Some co-ordination tasks can be taken care of by the new co-operative, while other co-ordination rests in the hands of politicians, i.e., legal harmonisation and other institutional amendments. In these respects, the new co-operative as well as various co-operative apex organisations can do nothing except for investigations, information dissemination, and lobbying. Still other types of co-ordination are out of reach for both co-operatives and legal bodies, i.e., differences in terms of market conditions, and geographical and climatic conditions.

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 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 and such so-called rationalisation may be extensive – humans have an inherent propensity to seek cognitive consonance.

For a cross-border 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, as they may also involve the slaughtering of "sacred cows". In other words, it is likely that many adaptation measures are not conducted, even though they are highly required, because the merging partners can not find any compromise. If the parties don't 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, the principles for appointing board members, location of the headquarters, the name of the new firm, etc. The merger party that loses this fight will 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 the present headquarters of MD Foods should also be the new headquarters. *"That was certainly a mistake"* admitted both the former CEOs, *"but at that time it was too big a risk moving the headquarters to e.g. Copenhagen"*. A few years after the merger, Arla Foods's staff has become strongly dominated by Danes. Only few Swedes work at the headquarters, as Jutland is too far away from Sweden and as so few other Swedes work there. Also very few Danes moved to work for Arla Foods in Sweden.

A location in the Copenhagen area, on commuting distance to 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 cosmopolitan-like. One could also claim that a staff with mixed nationalities might work less efficiently due to the risk for misunderstandings and conflicts. It is unclear to which extent employees of one nationality have difficulties to service persons of another nationality well. At least there is no evidence that the Danish dominance in Arla has caused any problems for the Swedish members.

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

It is likely that transnational co-operatives introduce more *politics* in their bylaws than national co-operatives do. Such paragraphs will never promote the economic records of the firm. If, according to the agreement, the CEO and the board chairman must have a specific nationality, it is not evident that the appointed persons are the very best ones. Certain issues are perhaps not discussed as they may harm the power balance, even though these issues may have large cost effects, e.g., moving a certain production line from one country to the other. Some evidently efficiency-harming rules may be upheld, for example that the members of one co-operative should have a higher pay than members in the other country. Those political matters may create conflicts as 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.

The political factors become the more important as a merger proposal can be expected to be met with suspicion and resistance by a large share of the members. It is understandable that the members have fear of many changes that may follow from the merger. So, in order to calm the waves within the memberships, the negotiations between the power-holders may result in more political rules than is economically justified, i.e., rules which do not create the strongest possible business firm.

For a cross-border merger between agricultural co-operatives to be initiated and to develop well, the advantages must dominate over the disadvantages, all subjectively perceived by the decision-makers – top-level people as well as rank-and-file members. As 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, which 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 didn't have the co-operative. 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 got a higher price for their produce in the first couple of years after the merger, as the Swedish milk price was higher than the Danish one prior to the merger. Only 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). If only the main categories are mentioned, one is that a co-operative, being organised according to collective principles, may increase the volume of processing operations more than any other organisational type. The raison-d'être of such a co-operative is 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 good 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, 2004).

- 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 & 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 are operating in small countries as these countries' small domestic markets make it difficult to reap sufficient *economies of scale*, even though the co-operatives operate nationwide. Alternatively, merging partner can be expected to be located in larger countries where the competition authorities object to nationwide co-operative societies (primarily 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, i.e., exploited by fraudulent buyers.

Also *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 the retail chains by having a few Spanish potato growers as members (Agricultural …, 1997, p 164). Hence, the co-operative can get better prices, whereby also the farmers' prices increase.

When explaining the rationale behind co-operatives, some authors mention social variables such as solidarity, cohesion, and mutuality (e.g., Craig, 1993). Such social values certainly exist in co-operative memberships to a varying degree, but they can never explain why co-operatives are established and develop, rather the opposite. The lack of social relations in a membership may explain why co-operative organisations sometimes deteriorate. Hence, no cross-border merger between co-operatives is driven by such social variables, though these contribute to understand why the merger process develops in one direction or the other.

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, i.e., whether a large majority of the memberships as well as the management and the board find that the members' profitability will be improved (Ringle & Keebingate, 2001). Some of the ones 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. Also 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 are 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, marketing, etc.
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, conduced in spite of quite some dissimilarities: (a) Even though Arla Foods pays exactly the same milk price to the members, the Danish and Swedish farmers get different amounts after tax. (b) The discussions about introducing a new ownership structure in Arla Foods has stretched over several years, one reason being that the tax consequences are different for the Danish and the Swedish members. (c) While GMO (genetically modified organisms) are accepted in Denmark, Swedish Arla Foods members are not allowed to feed their cows with such fodder, which gives them a cost disadvantage. (d) 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. As Arla and MD Foods were the dominant dairy co-operative at 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, also 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 in the Arla Foods case, because the retail industry is more and more dominated by large, also multinational, retail chains with an immense bargaining power.
6. If a merger should 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 considered to be *"a merger between equals",* though this expression was never clearly spelled out. 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. Thereby neither membership will feel as a looser. However, if both merging parties in an imbalanced power relation consider themselves to have equal power, conflicts are due to evolve.
7. Co-ordination could become easier if the two partners are similar in terms of business operations, whereby 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 if 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 of closing 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. There also have to be a transfer of resources and competencies among 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 on many foreign markets but its equity position was weak, 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 should have a good chance of being approved of 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 are unable to judge if a good milk price depends on the co-operative being successful or if the business cycle is rising. A few years after the merger of Arla Foods, the market conditions got worse, 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 have effects on whether a cross-border merger is initiated and conducted and whether the outcome is successful. These factors relate both to the membership and the leadership (board and management), and also the interrelations between these. Some examples are:

1. A merger is more probable if the partners are located in countries with *similarities in various cultural respects* (language, business mentality, etc). Although there are similarities between the Swedish and the Danish culture, there are also dissimilarities. *"We had to address these cultural differences if the merger was going to be successful. Fortunately we had a Dane who had been working in Sweden for Arla for many years, and he became a key person in the merger process, because he speaks both languages and he was also very aware of the differences in business mentality",* said one interviewee.
2. After a merger there is one CEO in stead of two, only one board, etc. In the world of reality, it matters if *the CEO* in at least one of the merging partners is close to retirement. The CEO of MD Foods became the first CEO of Arla Foods and upon retirement a few years later he was superseded by the former CEO of the Swedish Arla. This solution was considered fair. Also, through these exchanges, Arla Foods succeeded to keep a balance between nationalities during its first years – when the chairman was a Swede, the CEO was a Dane, and vice versa.
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 to convince the directors of a merger proposal. It is a matter of 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 and make sacrifices to make the change come through. In the Arla 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 they 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 to use the *voice option* – the individual's opinion is drowned. In case a business activity is characterised by extreme economies of scale, whereby the industry will consist of one single buyer, the farmer has difficulties to make use of his *exit option* – there is just simply no other to buy his produce. In both situations, the power-holders in the co-operative (the CEO and the board) will have better chanses to get a merger completed. If members have difficulties to protest verbally and if dissatisfied members have no other way to go, the merger will be realised. Only a few members left Arla Foods in protest to the merger. In Sweden, quite a number of members protested at meetings and in the mass media ("Arla is richer than MD Foods"; "Arla pays a better price than MD Foods"; etc.) though without gaining much support.
7. In case the members of a co-operative have economic difficulties in their farming operations, it is more likely that they 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.

If it comes to a cross-border merger between agricultural co-operatives, Danish-Swedish mergers are likely. Both being Scandinavian countries, there are lingual similarities, cultural links, and good logistical conditions. MD Foods and Arla were similar in size and types of operations. Both had during several decades gone through a large number of national mergers, and both realised a need for more market strength. Arla and MD Foods had five years before the merger established some common business operations, and MD Foods bought a Danish based company from Arla. So they had started their collaboration and integration long before the actual merger took place.

Summary

The driving forces behind the formation of cross-border mergers between agricultural co-operatives are strong. The markets for agri-food products are liberalised and internationalised. As the retail chains become multinational corporations with immense buying power, the suppliers of food products have to be very large firms in an attempt to gain bargaining power.

However, the internationalised market conditions give less room for member influence, and management power is due to increase. In a transnational co-operative, the social forces are different compared to in a national co-operative – both the forces within the memberships and those within the management team and the staff. The Board of Directors becomes increasingly dependent upon management and external markets.

4. The merger process

The role of management – corporate governance

National mergers between co-operatives are commonplace. Such have taken place in thousands 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, most often the same language, etc. Hence, it is no wonder that domestic mergers have taken place frequently and have been conducted easily in most cases (Utterström, 1980).

When it comes to cross-border mergers, the situation is different. There are weak social ties between farmers in different countries, if any at all. 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 members. Most rank-and-file members take a passive position in relation to their co-operative. An individual member has no incentive to promote a change for the entirety of the co-operative society. He would be stupid if he were to spend his personal resources for 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 has also strong motives – it is more gratifying being the CEO of a large firm than a small one, i.e., 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 of course involved already in an early stage of the merger process. Together the four constituted the merger negotiation team assisted by key managers from both parties.

If a CEO should be successful in his endeavours to merge his co-operative with another one from another country, he must have a strong position relative to the Board of Directors. Hence, cross-border co-operative mergers are more likely in cases where the CEO has been in service for many years. At the time of the Arla Foods merger, the two CEOs had been at their positions for about ten years, but they have been employed in their respective firms for another couple of decades. The Danish CEO was close to retirement age.

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 doesn't worry about property rights. The so-called *vaguely defined property rights* of such a co-operative will create agency problems, i.e., the principal has difficulty to control the agent (Cook & Tong, 1997). The management 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 co-operative business could be so large and so complex that they have difficulties to grasp it. 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-operative governance. 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 by the CEO. According to agency theory, this may bring problems as the agent is in control, not the principal, the membership. On the other hand, also the opposite stand is heard, i.e., that the membership benefits from a powerful CEO in co-operatives. In the context of a collectivistically organised 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).

In case that the members have little or no individual ownership to 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 are suppliers, and so, they care about the raw price that the co-operative pays for their raw products, and thereby 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, with detrimental effects on the equity of the co-operative. 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 to advance to another position. Hence, management may have a more long-term perspective on the business activities than members have. Also board members may apply a long-term perspective in their decision-making. No board member could stand the shame of being guilty for mismanagement of a co-operative, thereby causing economic problems for fellow farmers.

Some researchers claim that co-operatives are more risk-averse than IOFs, one reason being that co-operatives have a so-called double screening procedure (Hendrikse, in press; van der Krogt, in press). 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 principles.

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 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 not serve well as the bridge between the co-operative and the membership – they function as the management's prolonged arm. Even though the directors are principals for the agent, the CEO, they may act as if the relationship were the opposite.

The role of the memberships – co-operative governance

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. Another reason might be that management most often has weak links to the membership, i.e., managers have little possibilities to influence the members. Also, 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. However, dairy farmers in both Sweden and Denmark have limited exit possibilities as the other (very few) dairy co-operatives may not accept new members and suppliers.

The management in both Arla and MD Foods were well aware that integrating the firms is easier than integrating the societies. By putting a lot of effort in 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 the CEO wants his co-operative to merge with another co-operative, he must first of all convince the Boards of Directors. As the board consists of farmer-members, and the board members regularly meet rank-and-file members at meetings, as neighbours, and in many other forums, the board members assess the merger proposition according to the same criteria as the members do, i.e., whether an eventual merger might improve the co-operative's ability to pay a high price for the raw products. If the CEO can convince the board 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. Comparisons with a peer group of similar European dairy processors were instrumental.

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 are due to require affirmative answers. This stage is likely to be turbulent. 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 board members 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 arises.

When a merger between co-operatives is announced, no help can be expected from any qualified analysts as the shares are not listed at any stock exchange. So, mass media are of no help, and financial analysts have neither any interest in the merger, nor any possibilities to conduct analyses. All information about the proposed merger originates from the co-operatives involved. That is to say that the members' knowledge about the proposal comes from the co-operative, and actually from the staff at the co-operative firm, not primarily from the co-operative society. 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 integration of the co-operative societies is not the responsibility of the CEO, neither is he sufficiently well informed about what happens in the memberships.

The role of the member relations department

All the unanswered questions are likely to create scepticism in the membership. This means that the CEO and the board even more want the decision to be quick. Quick action implies organised action, and so, the member relations departments of the merging co-operatives get a heavy responsibility to inform the memberships. Rather their task is to advocate for the merger proposal to be supported by the memberships – impartial analyses can not be expected.

Arla Foods considers its member relations department to be an important instrument in the harmonisation of the two co-operative societies. In connection with the merger, seven so-called harmonisation groups were formed with representatives from both co-operatives. These groups discussed the seasonal payment system, quality programmes at the farms, organic milk, extension, sales of products to the members (cheese etc.), relations to national interest organisations, and the local membership organisation. The interviewees indicated that more resources were spent integrating the co-operative societies than integrating the business firms.

While the process of integrating the co-operative firms may start immediately after the merger and may be successful, the integration of the co-operative societies may be extended. An example is the results from a telephone survey, conducted in May 2005 among 134 of the 140 delegates (96% response rate) in Arla Foods' Board of Representatives. The survey concerns the merger proposal between Arla Foods and Campina, which was rejected by Arla Foods' board. The figures indicate huge differences in opinions about an issue of immense strategic importance (Table 1). On commenting this survey, one Swedish representative said: *"When meeting Danes, one may wonder if we talk about the same merger"* (Davidson & Ingvarsson, 2005, p 5). Evidently, the Danish and Swedish memberships are not well integrated.

Table 1: Findings from a survey among Swedish and Danish delegates in Arla Foods' Board of Representatives (Source: Davidson & Ingvarsson, 2005, p 5)

		Swedish delegates	Danish delegates	All delegates
What is your opinion about the fact that the merger between Arla Foods and Campina was cancelled?	Good	12.5%	48,7%	33.6%
	Bad	78.6%	37.2%	54.5%
	Don't know	8.9%	14.1%	11.9%
How would you vote if there was a proposal to vote about?	Yes	64.3%	38.5%	49.3%
	No	5.4%	23.1%	15.7%
	Don't know	30.4%	38.5%	35.1%
Do you have confidence in the Board of Directors?	Yes	71.4%	83.3%	78.4%
	No	19.4%	5.1%	11.2%
	Don't know	8.9%	11.5%	10.4%
Do you feel that you have any influence in your role as a member?	Yes	96.4%	78.7%	85.8%
	No	1.8%	9.0%	6.0%
	Don't know	1.8%	12.8%	8.2%
Do you think that the headquarters should be located in Aarhus?	Yes	14.1%	75.6%	50.0%
	No	76.8%	10.3%	38.1%
	Don't know	8.9%	14.1%	11.9%

When asked about the differences between the opinions of the Swedish and Danish representatives, the CEO suggested that a reason may be that the two groups were differently informed. If this is true, the member relations department has not been very successful.

The Board of Representatives is an important part in Arla Foods' member democracy. It can be regarded as the general assembly, though it congregates very frequently, discussing and voting on all major decisions about the co-operative's strategic issues. The members of the Board of Directors are elected among the members of the Board of Representatives.

When integrating two co-operative societies in different countries, problems are bound to appear. The chairman of the board of AVEBE (Dutch/German starch potato co-operative) and another board member mention a number of critical factors: "lack of confidence, wish to retain independence, bad knowledge of the other partner, issues about financing losses, German legislation versus Dutch legislation, details of the contracts, problems concerning production quotas, and consequences of bilingual communication" (De internationale …, 2004, p 4).

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 can not expect the memberships to share the same opinions. Also the opposite relation holds true, i.e., if there are significant differences between the memberships, there will probably be similar differences between the elected representatives. In other words, vicious circles are in 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, the degree of and type of business operations, etc. The Board of Directors in Arla was used to discuss mainly strategic issues as well as membership issues, while the board in MD Foods was also very concerned about more details in the business operations.

In the merged co-operative, harmonisation of these two views were imperative: *"The new Board of Directors in Arla Foods had to harmonise its ways of working, and therefore we had rather long board meetings in the beginning, with stretching-leg pauses every second hour. It was during these breaks that we really got to know each other"* (The first chairman of the board in Arla Foods).

In connection with the collapsed merger discussions between Arla Foods and Campina, mass media reports about 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. Especially, moving the head-quarters away from Aarhus was too much for some of the Danish directors, also because the head-quarter location was a sacred cow for their electorates.

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.

Summary

The idea that a merger should be conducted comes typically from the CEOs of the co-operatives, but also several other parties are involved in the process. The CEOs have to convince their boards, so that a merger proposal can be presented to the members for approval. As merger decisions require a qualified majority (75%), it is of utmost importance for the CEO and the board that the memberships become convinced. The member relations department of the co-operative is instrumental in the information campaigns, directed to the memberships.

The members' prime interest in their co-operative is the price that the co-operative pays for their produce. This is their main decision criterion. Knowing this, the CEO, the board and the member relations department stress the "payment ability" of the co-operative before the merger and after the merger. The consequences of the merger, presented to the members, are thus mainly expressed in economic terms. Also the fact that the CEOs are the engines behind the merger means that business matters come to dominate the merger issue.

Issues concerning how the two co-operative societies should be merged are extremely difficult in case of a cross-border merger, as the memberships live and work under different conditions. Perhaps the difficulties with the integration of the memberships into one new membership are a reason why the decision-makers overlook these issues. Another hypothesis is that the decision-makers' experience relate to national mergers, and they may believe that an international merger is similar to a national one. In the Arla Foods case the two parties were aware of this problem, so it was not overlooked but underestimated due to the fact that they thought they knew each other well long before the merger took place.

5. Conclusions

Due to current market trends one may expect the number of transnational agricultural co-operatives to increase in Europe within a near future. The markets are being liberalised – the CAP (Common Agricultural Policy) is under pressure. The food retail industry is more and more dominated by large multinational firms, having tremendous bargaining power. The consumer markets are being polarised, the main trend being towards more price sensitivity.

Becoming transnational is one way for agricultural co-operatives to gain market strength. The larger size of business operations means economies of scale. By recruiting members with a different kind of production some co-operatives may gain economies of scope.

Among the different routes towards becoming transnational, the one that has large and quick effects is cross-border mergers. Attracting members from neighbouring countries, establishing new transnational co-operatives and acquiring firms in other countries are slow and often resource-consuming solutions. However, till date extremely few cross-border mergers have been conducted, the largest one being the merger between Arla and MD Foods that resulted in one of the world's largest dairy co-operatives, Arla Foods.

The initiative to conduct a cross-border merger between co-operatives can hardly come from the members, and not likely from the board. Rather the CEOs of the merging partners are likely to be active since they are the ones who have knowledge and also have the most to gain from a merger. However, the CEOs' knowledge concerns primarily the business operations, not the membership relations. Hence, they are able to plan how the two co-operative firms can harmonise the operations but not how the co-operatives societies can be integrated. They can involve themselves in the corporate governance but less in the co-operative governance.

Co-operative governance is the responsibility of the Boards of Directors and the entire body of elected representatives as well as the co-operatives' member relations departments. So, the integration of the merging co-operative societies is dependent upon how well the CEOs succeed to convince the board members of the necessity of a merger – and all board members must be convinced, if the memberships are to be convinced.

The CEOs normally want the merger decision to be made quickly. In their information to the memberships, the business-oriented facts tend to dominate strongly. Hence, the merger decision is made without due consideration of the process whereby the two co-operative societies could be integrated into a new society.

What is said above may be applicable to co-operative mergers generally, but when the merging partners are from different countries, the problems become aggravated. Farmers in different countries have different production conditions; the market characteristics are more or less different; there may be different languages and other cultural traits; the institutional settings are different, etc. All in all, the integration of co-operative societies in different countries is a challenging task.

Corporate governance and co-operative governance are interdependent. If the two memberships are not turned into one single membership, conflicts can be expected between board members of different nationalities, and so, the best decisions are not made. If the co-operative's investments are suboptimal, the firm's result suffers, whereby the members will be dissatisfied with the prices the get for their products. This means vicious circles.

The overall conclusion 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 problems.

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