

10/26/2017



BOOM

CASE
STUDY

LOSING SIGHT OF PURPOSE - THE UNITED FARMERS' CO-OPERATIVE COMPANY



Elena Mamouni Limnios & Tim Mazzarol Co-operative Enterprise
Research Unit, University of Western Australia.

© Elena Mamouni Limnios & Tim Mazzarol, 2017 all rights reserved



Case Study Research Report | CERU



Centre for Entrepreneurial Management and Innovation (CEMI) & Co-operative Enterprise Research Unit (CERU)

Phone: +618 6488-3981

Fax: +618 6488-1072

Email: tim.mazzarol@cemi.com.au

General Inquiries:

Email: tim.mazzarol@cemi.com.au

Website: www.cemi.com.au

CEMI-CERU Case Study Research Report No. 1702

ISSN 2653-7036

© Copyright Elena Mamouni Limnios & Tim Mazzarol, 2017

Research Reports should not be reproduced without attribution to the author(s) as the source of the material. Attribution for this paper should be:

Mamouni Limnios, E., & Mazzarol, T. (2017) *Losing Sight of Purpose - The United Farmers' Co-operative Company*, CEMI-CERU Case Study Research Report, CSR 1702, www.cemi.com.au Centre for Entrepreneurial Management and Innovation.

NOTE:

This paper has been prepared in conjunction with the UWA Co-operative Enterprise Research Unit (CERU) www.ceru.au for the Business Council of Co-operatives and Mutuals (BCCM) <http://bccm.coop> who have provided the funding for this work.

TABLE OF CONTENTS

Introduction.....	3
History of UFCC	3
A “Spartan” operation (1991-1994)	3
The Golden Era (1995-1999).....	5
Full-service provider, diversification and trouble (2000-2005)	7
Back to basics (2006-2008)	9
The final years and demutualisation (2009-2013)	10
MOCA and the Membership Value Proposition.....	12
Marketing Our Co-operative Advantage	12
Member Value Proposition	13
UFCC’s MVP	14
Strategic positioning and the MVP	16
Managing strategic growth.....	18
The Financing of UFCC.....	19
The challenges of being a fast growing ‘pacemaker’ co-operative.....	19
UFCC’s financial performance	20
The Governance Challenges of UFCC.....	23
The importance of good governance	23
The foundation of UFCC	25
Governance failure	25
Property rights and agency theories	29
Key Lessons from the case.....	31
References	32

INTRODUCTION

A few passionate and determined farmers got together in the early 1990s and created the United Farmers' Co-operative Company (UFCC) to fight off the oligopolistic fertiliser market in Western Australia. UFCC grew exponentially for a decade but faced several challenges leading to a sharp decline and eventually was acquired by a larger, New Zealand fertiliser co-operative Ravensdown. However, this relationship did not last and by 2013 the co-operative was demutualised through its sale to global agribusiness commodities trader Louis Dreyfus Commodities (LDC).



HISTORY OF UFCC

The following sub-sections outline the history of UFCC, from its initial launch in 1991, to its merger with Ravensdown in 2007, and its eventual trade sale to Louis Dreyfus. Later sections will examine the marketing, financial management, and governance of UFCC.

A "SPARTAN" OPERATION (1991-1994)

In the early 1990s the oligopolistic fertiliser market in WA was one of the factors contributing failure and hardship within the wheat farming sector. Fertiliser is one of the largest farm input costs and along with pesticides they account for over 30% of total farm expenditures (DAFWA 2009).

By 1991 rural Western Australia was in crisis. Successive poor seasons, high interest rates and an international price of wheat below the cost of production, drove wheat farmers to protest on the streets. There they demanded a minimum price of wheat to be guaranteed (subsidized) by the government.

In April 1991 the Rural Action Movement (RAM) was established to progress farmers' interests through political action. The president of RAM Max Johnson, and his deputy Rod Madden, were both young, visionary individuals who quickly realized that political intervention was not going to resolve the farmers' short-term challenges.

RAM decided to import fertiliser to break the duopoly of CSBP (part of Wesfarmers Ltd) and Sumitomo (trading as Summit Fertilisers Pty Ltd) that at the time enjoyed high profit margins. Organising the financing for the first shipment was an administrative ordeal. However, a total of \$9.7 million was raised in about seven days, but the bank nearly pulled out as RAM was not an incorporated body.

After an eight week struggle the financing was finalized and RAM successfully imported a 15,000-tonne shipment, delivering savings that collectively accounted for millions of dollars for WA farmers. As noted by the founders of UFCC:



“The price of urea, which is a nitrogenous based fertiliser, was about \$325 per tonne on the market...we dropped the price by \$115 per tonne”.



Rod Madden



Max Johnson

Source: Warren (2002)

UFCC Leaders Rod Madden and Max Johnson (source Warren, 2002)

UFCC was formed the following year to provide an incorporated body that would facilitate transactions with the banks. However, an early dispute in 1992 led to one of the founding directors, and the first manager leaving. The following year John Read was appointed as General Manager. During 1993 UFCC made a record breaking \$1.14 million profit in its first year of operations, all of which was rebated to shareholders (Warren 2002, p.26).

By breaking the duopoly of investor-owned firms CSBP and Sumitomo, UFCC corrected the market within a few seasons, significantly reducing farm fertiliser costs. UFCC started with a simple business model, as an agricultural low-cost supply co-op that aggregated purchases of fertiliser for its members. The competitors were slow to respond and UFCC dropped the market price by \$100 per tonne in 1994, rapidly gaining market share in the process. By 1994 UFCC had grown to more than 750 members (Warren 2002, p.22).

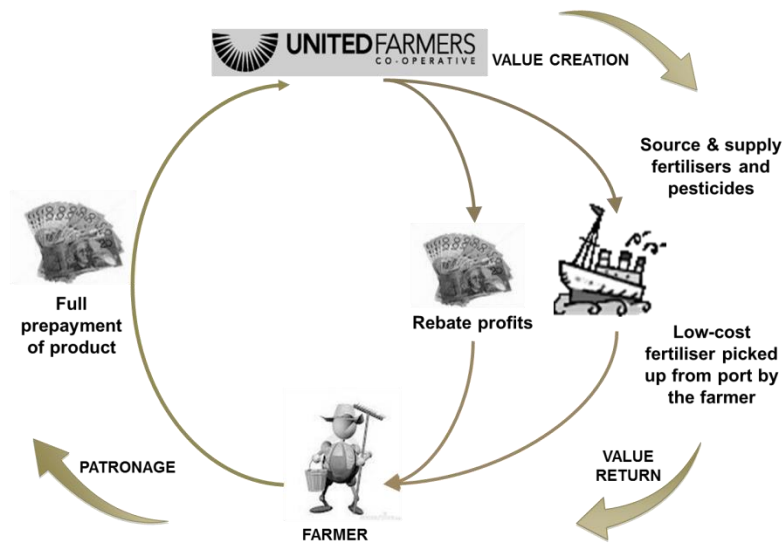
In those early years UFCC ran a “Spartan” operation, with no storage facilities to keep handling costs as low as possible. Farmers had to bring their own trucks to the port to collect their fertiliser supplies, which proved a logistically challenging exercise.

UFCC had no storage facilities until 1995 and minimum staff which enabled them to keep overheads low. The profit formula was also very simple, as farmers were required to pay for their



order up-front. Any profit made after cost of goods sold at the end of the season was returned to the shareholders as a rebate.

The member value proposition (MVP) offered by UFCC was built on a cost leadership positioning strategy (Porter 1981). A no-frills, do-it-yourself (DIY) model that is reflective of the disruptive market entry strategies of new entrants in other sectors (e.g., retailing, budget airlines). The figure below illustrates the UFCC business model.



UFCC Business Model “Survival Stage” 1992-1994

As this early start-up period came to an end, the first General Manager John Read, proved not to be a “good fit” with the organisation, and was replaced in 1994 by the appointment of Ian Barnden-Brown as General Manager. At this time the board was very ‘hands on’ and became closely involved in the executive management of the co-operative.

THE GOLDEN ERA (1995-1999)

The second half of the 1990s is remembered by many former members as the “Golden Era” for UFCC. In 1994-1995 UFCC entered the chemicals market (pesticides), where again they delivered significant savings to their members. As noted by one former UFCC director:

“The price of glyphosate came down from something like \$18 to maybe \$9 dollars a litre and we were making significant profit on that.”

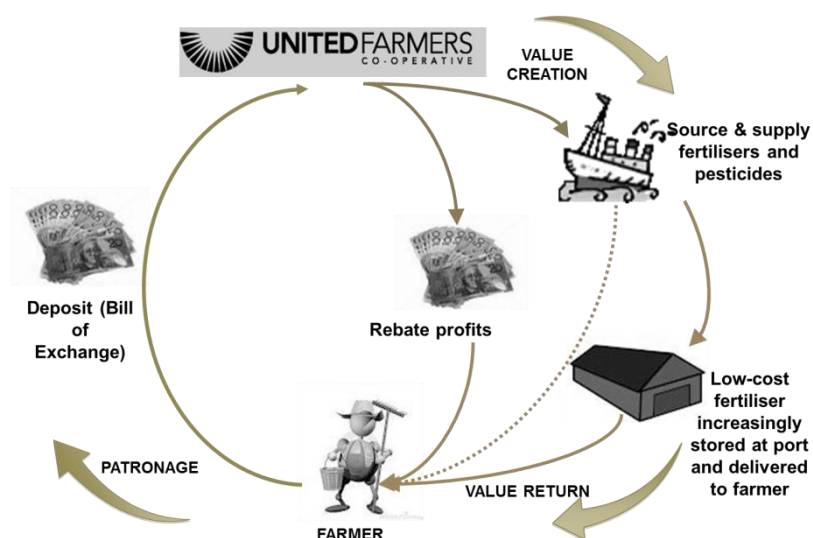
In 1995 there was a significant change in the UFCC business model with the introduction of storage facilities which expanded year after year to cover all major WA ports, achieving rapid enterprise growth.

In addition to diversifying into chemicals and more innovative fertiliser blends, UFCC introduced a major change in their capital structure and operational processes by acquiring storage facilities in the port city of Fremantle (1995), and subsequently at Naval Base (1997) and Geraldton (1998)

in the mid-west of Western Australia. Later they expanded to the southern ports of Esperance (1998-1999) and Albany (2000). Fixed assets increased overheads but were critical in enabling operations to scale up. Membership increased exponentially whenever a new facility was opened. Founded with only five members in 1992, UFCC grew to more than 1,750 members by 1999 (Warren 2002, p.37).

The year 1995 also signalled a shift from the early infant stage into the second stage of development in what Cook (1995) describes as the co-operative life cycle. The introduction of innovative fertiliser blends and pesticides increased the variety of product offerings, while the business invested in corporate planning, director training, and formalised operational processes (Warren 2002, p.12).

The profit formula also changed in 1995-1996 with the introduction of the bill of exchange (later to become direct debit requests). Farmers placed an order paying only a partial deposit and the co-operative was able to borrow against it to a maximum of 70% of the Bills. This later introduced challenges associated with the cost of debt, accumulation of inventory and financial management if many farmers simultaneously cancelled orders. The figure below illustrates the UFCC business model of this period.



UFCC Business Model “Acceleration Stage” 1995-1998

The key drivers of success during this “Golden Era” include a member commitment built through early success and significant farmer savings in previous years, as well as the farmer board that maintained a close connection to members. In addition, the co-operative was run by a small, tightly-knit, and competent management team that introduced new management systems and procedures to support financial management and administration. Further, they also established unique trading agreements such as the *Progressive Pricing Agreement* with suppliers which provided fixed pricing for later shipments reducing the co-operative’s risk exposure.

Sales doubled each year for three consecutive years and in 1998-1999 the board of directors formalised their intention to pursue a diversification strategy beyond the fertiliser and chemicals

market. Barden-Brown remained in charge of the fertiliser operation, while John Connell was appointed as the first CEO in 1998. As a result, Barden Brown left in December 1998. In less than year, two more members of the long serving management team also left UFCC, leading to a complete change in management. The year 1999 marked the establishment of the United Farmers Mutual and a grain division. However, the latter remained dormant until 2002.

FULL-SERVICE PROVIDER, DIVERSIFICATION AND TROUBLE (2000-2005)

There are differing opinions amongst the former directors as to whether UFCC changed its strategy in the period 1999-2002. Some maintain that right from inception the board's vision had always been to grow UFCC into a diversified service provider. Indeed, evidence supports this argument as unsuccessful attempts to diversify into wool processing and meat marketing had taken place as early as in 1993 (Warren 2002, pp. 19-20).

Although discussions and investigations of various business opportunities may have taken place at the board level, the period 1995-1999 was clearly dominated by a growth strategy focused on the core businesses of fertiliser and chemical supply. However, two difficult seasons in 2000 and 2001, combined with a cargo contamination in 2000 placed UFCC under financial pressure. In 2001 the Chairman announced that consideration was being given to capital-raising options and closing the co-operative to non-members (UFCC 2001, p.4).

As a result of these financial problems the then CEO John Connell lost the board's trust and confidence, and he was replaced in 2002 by Tony Usher. The board and the new CEO then worked towards transforming UFCC from a low-cost provider to a full-service rural provider. The term commonly used at board level was "drought-proofing" the business. Over the period 2002-2004, CEO Tony Usher pursued a differentiation strategy using terms describing UFCC's business as that of a "full rural service provider", "crop protection" and "circle of service". As one former director recalls:

"He [Usher] wanted the full service for rural based people, so wool, sheep, grain, fuel, insurance, whatever we produced or needed".

However, this expansion strategy did not always go smoothly. For example, in 2002 a long-term 21-year lease of a high-capacity Kwinana storage facility became operational and in 2002/2003 UFCC set an ambitious Grain Business Plan to achieve a top-three position in WA within three years.

When presented with this proposition for a long-term, 21-year lease of a storage facility in Kwinana (Clayton Utz 2001), board director Gary Cosgrove strongly disagreed. Despite these reservations, the board signed the contract in December 2001.

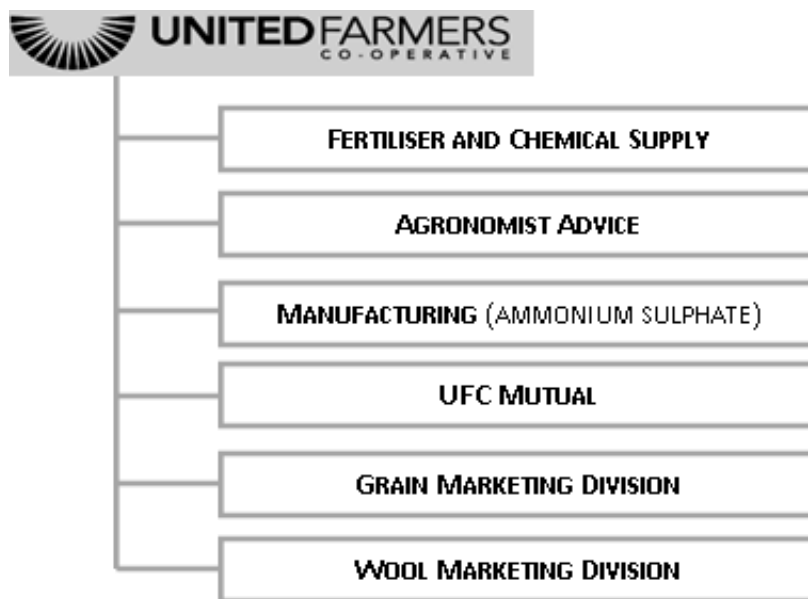
Unfortunately, the envisioned throughput never materialised, and this lease proved to be a key driver of the increased operational costs of the co-operative. A decade later the new owners, Ravensdown, were still dealing with a 200% more expensive per unit storage in comparison to competitors' costs in the Kwinana area. In addition to being a binding contract for 21 years, the



agreement had several prohibitive conditions including make good clauses (e.g., repair and maintenance).

In 2002-2003 UFCC diversified into manufacturing through the development of an ammonium sulphate compactor plant. UFCC did not have any experience in compaction or manufacturing and failed to adequately research the new technology they employed. The product proved to be faulty as it broke down as soon as it went in the air-seeder. The manufacturing plant was a \$9 million investment (the initial contract was for \$6 million), making it the single biggest investment the co-operative made in its 17-year history.

By 2005 UFCC had evolved to a multi-purpose co-operative as illustrated in the following figure.



UFCC Business Model “diversified” 2005

The co-operative’s rapid growth strategy also saw a significant increase in the size of the UFCC workforce, which added significantly to overhead costs. This was also taking place at a time when many of its competitors were downsizing due to changes in the market that required a lowering of operating costs to remain competitive. As one former UFCC director explained:

“In one year, we went from 6 company cars to 40. He [the CEO] often had the philosophy that he would rather have one too many staff than one too few and that replicated across the business. In the same period CSBP sacked 600 staff members.”

As a result of these problems some of the board directors became increasingly uncomfortable with the progress of the new strategy. In 2002 a long-serving director Gary Cosgrove resigned from the Board. The following year, UFCC’s co-operative structure, the value of diversification,

and the aim of growth vs. efficiency were all debated at board level (UFCC 2003). By September 2003, disagreements over the proposed budget escalated into a major board fall-out, resulting in the resignation of the Chairman Rod Madden and two board members early in 2004.

In their letter to shareholders these disaffected directors mentioned deficiencies in corporate governance, the decision of the board to change the strategic direction of the co-operative, the failure to maintain a low-cost structure and sales that benefit non-members (Madden, Dempster, and Chamberlain 2004). However, the new board, chaired by Max Johnson, continued to pursue the diversification strategy.

In 2005 UFCC introduced what they called “seasonal finance”, which was extended credit so members would get their fertiliser and agricultural chemicals supply prior to planting and pay for them after harvest. The larger competitors were also providing this service. However, that was done through their agent network, as one former director explained:

“Wesfarmers and CSBP [were] supplying fertilizer through Elders and Landmark and Elders and Landmark were carrying the finance risk, not the fertilizer supplier. There was another link in their chain. We supplied extended credit to once again stimulate more sales. We charged an interest premium on that and as security we would take a lien over the shareholder’s crop. As time proved, in the years when the seasons were poor and there was no crop, the crop liens were worthless because there was no physical to deliver against them, so we held a bit of paper, and the farmer had no grain. At the end of the day UFCC lost that credit.”

This strategy, combined with rising costs, resulted in cash flow problems for the co-operative and in 2004-2005 UFCC did not issue a rebate to members for the first time since 1995. Further, the interest-bearing debt had increased from \$14 million in August 2004 to \$33 million in August 2005.

BACK TO BASICS (2006-2008)

Diversification was certainly a reasonable strategic direction, which seemed to follow a general trend in the WA agricultural industry at the time. A typical example was the 2002 merger of Co-operative Bulk Handling (grain handling co-operative) and the Grain Pool of WA (grain marketing agency) into the formation of what became the largest co-operative in Australia, the CBH Group Ltd. (Co-operatives WA 2011).

The CBH Group Ltd diversified further in 2004-2005 with acquisitions of Asian flour mills that later helped support CBH’s profitability, offsetting the volatility associated with grain handling and marketing. However, in UFCC’s case, poor investment and management decisions did not materialise into the envisioned economies of scale.

UFCC’s business model as a supplier of farm inputs was highly dependent on the natural environment and was vulnerable to droughts that depressed sales. The droughts in 1995, 2000-

2001 and then in 2006-2007, in conjunction with low profit margins resulted in significant financial pressures for the co-operative.

The bad season of 2006-2007, coupled with over supply of fertilisers, thinned UFCC's bottom line in a critical organisational restructure phase and resulted in the loss of bank support and pressure to seek external capital. The risk introduced by the dependence on the natural environment is one of the major threats facing agricultural co-operatives, and a mix of strategies is required to ameliorate the risk through diversification, flexibility in operational size and overhead costs; plus investing in the social cohesion and loyalty of the member base.

In addition, UFCC faced the risk of commissioning a single ship, in conjunction with holding no inventory in the early years. The supply of fertilisers is time critical and if the major shipment did not arrive in time or presented a major problem (which occurred in 2000), UFCC would lose members and credibility in the market.

In 2006 fertiliser sales accounted for 80% of the co-operative's revenue, although the other business units (manufacturing, chemicals sales, grain marketing, wool marketing) were still operational. In October of that year, UFCC exited its grains business when it changed from a principal to an agency position moving into a commission structure. At this time, they also tried to sell their wool business, but as they could not find any buyers it was closed.

At the 2006 annual general meeting (AGM) members did not support Max Johnson as Chair, and shortly after that the co-operative's CEO, Tony Usher, resigned. A new board was formed, chaired by Bowe Wilson, that immediately implemented a "Back to basics" program, cutting back \$6 million in costs associated with warehousing, salaries, and logistics (UFCC 2007), as well as introducing volume discounts.

By 2007 cost savings were overshadowed by the effects of drought and high fertiliser prices, resulting in a loss of \$7.98 million (UFCC 2007). UFCC appointed PricewaterhouseCoopers to find potential options for raising equity capital. As a result, the board entered exclusive discussions with Ravensdown, a New Zealand based fertiliser co-operative, and recommended a merger at the 2007 Annual Meeting. UFCC was acquired by Ravensdown in January 2008 for an upfront payment of \$6 million (Beyer, 2008; Co-operatives WA 2008).

THE FINAL YEARS AND DEMUTUALISATION (2009-2013)

Ravensdown's entry into the Australian market not only involved the acquisition of UFCC in WA, but also the establishment of operations in Queensland supplying to sugar cane growers, as well as South Australia and Victoria. This was undertaken within the latter two states via an Adelaide-based joint venture Direct Farms Ltd. The former UFCC enterprise was operated as a solely-owned subsidiary Ravensdown Fertiliser Australia (RFA).

Unfortunately, the initial hope of a stable and secure future for the co-operative did not last. A series of droughts and increased competition over the period 2009-2012, as well as the impact of the Global Financial Crisis (GFC) of 2008-2010, resulted in a series of year-on-year losses for Ravensdown. This culminated in a trading loss of \$9 million in 2013 within its WA operations (RNZ 2013).

By mid-2013 Ravensdown was seeking to exit from Australia and had opened discussions with potential buyers. As CEO Greg Campbell explained at the time, there were many factors that led to the demise of the co-operative:

"Ravensdown has encountered its fair share of challenges since it entered WA in 2008. With the droughts, a global financial crisis and seesawing grain prices, a number of farmers in WA have had a grim time of it. With so many players competing for an increasingly scarce rural dollar, it's no surprise that volumes and margins have been constantly under pressure in WA. We will be doing all we can to keep communicating with shareholders, staff, and agents during what is bound to be an unsettling time for all" (Farm Weekly 2013).

The final sale of the RFA operations to Louis Dreyfus Commodities (LDC) took place in December 2013 for an undisclosed amount. By the time of sale, the enterprise had around 4,000 WA-based shareholders, and was employing about 39 people (Cattle 2013). In concluding the deal, the CEO of LDC Robert Green explained that the company would bring to the farmers a 'full portfolio' of products and services including fertilisers, crop protection and seeds, he noted:

"It highlights our confidence in and continued commitment to agriculture in Australia, where we have been present since 1913," (Cattle 2013).

However, in Queensland the Canegrowers who relied on Ravensdown for their fertiliser were reported as being 'devastated' by the co-operative's departure from the market, fearful of a rise in fertiliser prices (McConchie and Zonca 2014). Their grain producer counterparts in WA were also disappointed by the sale of Ravensdown's Australian operations. Despite their expectation of receiving full payment for their share capital, by March 2014 this payment had not been made, and there were difficulties caused by the Ravensdown co-operative's constitution.

Under the constitution of Ravensdown (NZ), where the members' shares were held since the acquisition in 2008, the co-operative did not have to redeem share capital until a member had failed to actively trade with the co-operative for five years (Morrison 2013). This was apparently not something fully understood by the WA shareholders when they agreed to the sale of the WA business. This led to a dispute between Ravensdown and its Australian shareholders.

According to Ravensdown's CEO John Henderson, speaking in March 2014, the co-operative indicated it was committed to paying the Australian member-shareholders. However, he explained that the matter was complicated:

"I was hopeful we'd have something back to look at in time for our March 24 board meeting, but I now know we won't have that. We have New Zealand shareholders too and the company's act here in New Zealand sets out rules and constitutional guidelines we've got to follow" (Hinkley 2014).

In response, farmer and long-term member and shareholder co-operative Bill Scott from Watheroo said:

"I think the large majority of grower shareholders have been expecting to be paid any day since the deal was finalised," he said. In January I was informed by Ravensdown that the issue would be resolved at its January board meeting. It would be nice for us all to be rewarded for our loyalty. Hopefully those involved will see sense and do it straight away otherwise it's going to damage what has been, up until now, a good reputation" (Hinkley 2014).

Despite its short history, UFCC had a lasting impact on the structure of the fertiliser market in WA, delivering a significant benefit to West Australian farmers in the last two decades and possibly for generations to come. Nevertheless, the rise and demise of UFCC is a lesson for directors and executive managers of co-operative and mutual enterprises (CMEs).

MOCA AND THE MEMBERSHIP VALUE PROPOSITION

As the short history of UFCC outlined in Group Problem Solving Exercise 1, illustrates, the co-operative experienced rapid growth as it filled an important niche within the fertiliser market dominated by major investor-owned firms (IOF). Its low-cost strategy enabled it to quickly secure market share and build up its membership.

However, this rapid growth also imposed challenges of managerial leadership on the board and its senior executives, which resulted in serious divisions that were exacerbated by drought and financial losses. In this group problem solving exercise we examine the UFCC business model and how it dealt with marketing its co-operative advantage to members, and the member value proposition (MVP) it sought to offer.

MARKETING OUR CO-OPERATIVE ADVANTAGE

According to Webb (1996) the key difference between co-operatives and other forms of business is that they are people-centred rather than capital-centred. Their focus on member welfare and benefit, both economic and social, makes the co-operative an enterprise that should be actively marketed in terms of the value that it offers.

The concept of 'Marketing Our Co-operative Advantage' (MOCA) was developed by Webb (1996) to help co-operatives understand how best to engage their members. At the heart of this concept is the notion that the education of members in relation to the co-operative's purpose, principles and values is a fundamental part of winning the trust and loyalty of the membership:

"When the member walks into the store you are educating. What they see when they go into that store tells them a lot about what you believe in, what your principles and values are. If they go into a co-op store and they see the same attempts to rip them off that they see in any other store, you have taught them

Co-operative Enterprise Research Unit (CERU)
Losing sight of purpose – The United Farmers' Co-operative Company

something that \$10 million worth of pamphlets or 200 courses will not change; you have taught them not to trust you” (Webb 1996 p. 12-13).

According to Webb (1996) most businesses undertake ‘image marketing’ that seeks to get the customer to believe that value is defined by short-term discounts, special offers and new or improved features.

However, such value is transient and rarely engenders long-term loyalty. By contrast the better approach is what he calls ‘character marketing’, which focuses on communicating the authentic nature of what the business has as a core purpose and what it should matter to the customer.

For example, he suggests that:

“Character marketing creates the basis for deeper relationships. For co-operatives, that is a unique advantage. It is not hard for co-operatives to build deep relationships; that is their uniqueness. Co-operatives are relationships. Relationship or character marketing for co-operatives is just a natural” (Webb 1996 p.14).

Well managed co-operatives have a clear purpose, and a coherent MVP that they use to engage current and potential members in an education process to communicate the value they offer. Where this is delivered with honesty, integrity and passion, the co-operative can win the trust and loyalty of its members.

MEMBER VALUE PROPOSITION

The ability of a co-operative or mutual enterprise (CME) to engage with its membership and secure their loyalty starts with the overall value that it offers to its members. This *Member Value Proposition* is a key starting point for any CME seeking to attract and retain a loyal membership base (Mazzarol *et al.* 2011; 2013; Suter and Gmur 2013).

Research into how members view the value propositions that they get from their co-operative or mutual enterprise, suggests that it comprises both social and economic motivations. For example, a large-scale study of members of credit unions found that value was perceived in terms of ‘technical’ factors (e.g., interest rates, access to services, credit etc.), and ‘relational’ factors (e.g., interpersonal relationships with credit union staff, sense of ownership and right to ‘have a say’ in its operations, feeling that the credit union listens and cares). Of these, the relational factors were the most important (Byrne and McCarthy 2014).

CMEs are essentially service enterprises through which members trade as buyers or sellers, and they can be broadly classified into consumer-owned, producer-owned or hybrids that do both (Birchall 2011). The value that the member perceives is often dependent on the nature of their engagement with the co-operative, which can include one of four roles or ‘hats’ that they wear. These are the roles of: i) a patron (producer seller, or consumer buyer); ii) an investor

(shareholder); iii) owner (member with voting rights); and iv) community member (member of a community of purpose for which the co-operative was established to serve).

A study of three large Australian co-operatives (Mamouni Limnios *et al.* 2018) examined how these ‘four hats’ were understood by the senior managers and directors of these co-operatives, and then communicated to the membership as an MVP. What emerged from this research is summarised as follows:

The ‘Patron Hat’

The value perceived by members from the ‘patron hat’ is about the quality and efficiency of service transactions with the CME, as well as prices paid. Value comes from use and those that trade more will derive more value than those that don’t. However, the directors and managers of the co-operatives understand that they provide a service that is about enhancing the member’s value rather than the value to the co-operative as a business.

The ‘Investor Hat’

The ‘investor hat’ is understood in terms of dividends paid to members, as well as the rise in the value of the shares as an investment where such share structure exists. For CMEs that have share structures that allow for distribution of dividends, the accumulation of shares is typically based on patronage, and members can often choose to receive dividends, or have their share distributions reinvested into the CME. In CMEs that don’t distribute dividends, the investment value is often understood in terms of the value that any investment provides to the member through their patronage.

The ‘Owner Hat’

The ‘owner hat’ is broadly understood in terms of the members as owners, who have the democratic right to participate in the CME via AGMs, and who have equal rights via the one-member-one-vote principle. For the directors of the board, the CME must view itself as existing solely for the benefit of its members.

The ‘Community Member Hat’

The ‘community member hat’ is closely related to the purpose for which the CME was established. Its value is perceived in terms of how the CME fulfils that purpose and helps to deliver the economic and social benefits to its members and the communities that they represent.

In essence the CME must understand what its members perceive as value, and how value is perceived and delivered around the ‘four hats’ that comprise the key roles played by members. Its ability to make a coherent and compelling MVP to its members is an essential element in the success of a CME.

UFCC’s MVP

As earlier, UFCC’s establishment was driven by the perceived market failure of the highly oligopolistic fertiliser market that existed in Western Australia during the early 1990s. The duopoly of Wesfarmers CSBP and Sumitomo had enabled fertiliser prices to rise along with other key farm inputs (i.e., chemicals), which accounted for over 30% of total farm input costs (DAFWA 2009).

By breaking the duopoly of investor-owned firms CSBP and Sumitomo, UFCC corrected the market within a few seasons, significantly reducing farm fertiliser costs. UFCC started with a simple business model, as an agricultural low-cost supply co-operative that aggregated purchases of fertiliser for its members. They had no storage facilities until 1995 and minimum staff which enabled them to keep overheads low.

The profit formula was also very simple, as farmers were required to pay for their order up-front. Any profit made after cost of goods sold at the end of the season was returned to the shareholders as a rebate. The foundation member value proposition (MVP) offered by UFCC was built on a cost leadership positioning strategy (Porter 1981). A no-frills, do-it-yourself (DIY) model that is reflective of the disruptive market entry strategies of new entrants in other sectors (e.g., retailing, budget airlines).

As noted by founder director Rod Madden, the early years of UFCC saw the co-operative offer a very compelling MVP:

“Farmers thought we were wonderful. They couldn’t believe it. Because we only had a capital base of \$5,000 to start with, farmers had to pay up front before we actually ordered the fertiliser. That enabled us to go forward into the next year with retained profit.”

Would UFCC have been more resilient, had they remained a low-cost provider of fertiliser and chemicals only? Interviews with many of UFCC’s former directors suggests that this might have been the case, but others disagree.

UFCC did move quickly from a simple low-cost ‘no frills’ business model to a more complex, diversified operation which brought along a series of challenges. However, their initial model as an agricultural supply co-operative faced structural, strategic, and competitive limitations such as: i) very low profit margins; ii) high environmental dependencies; iii) inability to attract large growers, and iv) powerful competitors.

This highlights a common challenge faced by co-operatives as members’ interests and organisational needs compete for the allocation of profit. Pressures for higher rebates are more likely when members receive benefits primarily through patronage and patronage related rebates, having a weaker investor and/or owner identity. International best practice on co-operative financing suggests that co-operatives should have a healthy profit margin and retain 50% of their annual profits, while returning the other 50% to members as a mix of cash rebates and a redeemable form of equity (Rabobank 2011).

Furthermore, the fertiliser business was unable to attract the larger farmers, who were offered attractive case-by-case volume discounts by competitors. Being a co-operative, UFCC would guarantee all its members the same price based on the principle of equitability (one-member-one-vote), thus providing an attractive proposition to small and medium size growers that did not have the negotiating power with IOFs.

Larger growers did of course also benefit from the overall fall of prices, effectively free-riding on the presence of a co-operative in the market. Some board members initially believed that the whole WA market was open to them, however it gradually became clear that this was not the case, and the exponential growth could not be sustained based on fertiliser sales as that side of the business entered the maturity phase of its life cycle.

Finally, the fertiliser business was initially successful because competitors were slow to respond to UFCC's price. They did not seem to view UFCC as a major threat at the time or preferred losing some volume mostly from smaller farmers rather than profit margins throughout their key customer base. However, UFCC's low price and rebate was indirectly subsidized by the farmers who were willing to pick up their stock at their own costs.

As UFCC volumes grew and competitors dropped their prices, direct pick up became unsustainable from a logistics perspective (and eventually not a legal alternative to UFCC due to restructures driven by their competition) and was also not a priority or even desirable by most shareholders. As UFCC added the necessary storage facilities and management overheads they introduced a structure very similar to their competitors who had larger market shares and were at the time focused on bringing down their costs.

UFCC used the fertiliser business to subsidise their other projects and kept forcing the price up and up closer to its competitors, we may never know what price they could have maintained had they remained focused on the fertiliser and chemicals business. The limitations to reaching the larger farmers as discussed above indicates that they would most likely remain a smaller player in the industry, not achieving the economy of scales that their competitors could achieve.

STRATEGIC POSITIONING AND THE MVP

The MVP is not just associated with the attraction and retention of members or the pursuit of a CME's purpose. It is also a process of strategically positioning the firm's business model within its target markets. Porter (1991) has suggested that a business needs to choose one of two 'generic' strategic positioning strategies. The first of these is that of a low-cost producer, whereby the business keeps its costs of production lower than the industry average and competes either on lower prices or maintains an average market price but secures more profit from every unit sold. The second 'generic' positioning strategy is that of a differentiator, whereby the business offers ways to add value to its products or services via innovation. This is typically possible only where the buyer is willing to pay a premium for the added value, and where it is possible to introduce product or process innovations that can deliver different bundles of value to the buyer.

Over time UFCC's strategy shifted and in turn this impacted the co-operative's member value proposition (MVP). As noted above, the initial market entry strategy of cost leadership and DIY may have proven attractive to some of the smaller farmers. However, as the co-operative developed its infrastructure and added overhead costs it moved to an MVP that was little different to the benefits offered by the mainstream IOF competitors.

By the mid-1990s the board of UFCC was realising that they could not compete based on a low-cost strategy only. Until then the menu of fertilizers that had been available in Western Australia was, as one former UFCC director explained:

Co-operative Enterprise Research Unit (CERU)

Losing sight of purpose – The United Farmers' Co-operative Company

“Unsophisticated, unimaginative and was certainly nowhere near as innovative as most of the rest of the world”.

UFCC employed an agronomist expert and over the following years introduced innovative fertiliser blends, provided agronomist advice to members, and introduced customised blends, which provided a significant point of difference to their competitors.

The decision to diversify away from fertiliser and chemicals into more complex products and services required a fundamental change to the co-operative’s business model. However, diversification projects were not approved by the board following a substantial evaluation of the way the business model would be impacted. There also seems to have been little examination of how members would embrace this new MVP and if in fact these changes were perceived by them to represent “value”.

As the IOF competitors eventually reacted to the growth of UFCC their focus was on hitting the co-operative where it was most vulnerable. As director Max Johnson explained:

“They had obviously looked at our weaknesses and realised the biggest problem UFCC had was a lack of capital. They came up with the concept of encouraging farmers to place an order early – in October/November – and pay up-front. They were telling farmers that the market was going to go in the opposite direction so they should purchase early and get the benefit. We were caught out because we really couldn’t start marketing our product until January, February, or March. Effectively the market was taken away from us.”

By the late 1990s it became evident that the co-operative could not sustain the same rates of member growth as they were firstly not as appealing to the larger growers and secondly the price gap between UFCC and their competitors was closing due to the introduction of storage facilities and subsidised agronomist service.

Different recollections of the key drivers of the initial diversification efforts emerged at board level. According to some interviewees, diversification projects seem to have been “personality driven. Others felt that the diversification strategy:

“...was based on the belief that the co-operative was an extension of the farm and should therefore be in the business of supplying or marketing various farm inputs or outputs” (source: interviews).

Later, the term “drought proofing” the business emerged as the key driver of diversification as the board became aware of the environmental dependency of the business model. The theory for the formation of co-operatives offered by neo-classical economic theory is that:

“The co-operative business form is constructed so as to attain large volumes of business and thereby reap economies of scale” (Nilsson 2001).

MANAGING STRATEGIC GROWTH

The challenge of re-inventing the UFCC business model ultimately proved too great for the co-operative’s board and executive team. As noted above, the original MVP was a low-cost, DIY solution that appealed to those farmers who were particularly price sensitive and willing to manage their own logistics. This was often the smaller producers for whom cheaper prices were the most significant factor.

However, as UFCC expanded its operations and developed its storage and distribution systems the business model and MVP had to change. UFCC effectively transitioned from a focus cost leadership strategy to a differentiation strategy that it lacked the financial and marketing resources to fully implement. It suffered from what (Porter 1991) refers to as becoming “stuck in the middle”; a situation in which the business lacks any clear position in the market.

For a differentiation “full service” business model to work effectively the membership would have to attach greater importance to the value offered by these new services than they did to lower prices for their fertiliser and chemicals. Further, it would also be necessary that UFCC could innovate sufficiently in the way it delivered these new services to enhance their perceived value to the members (Murray 1988).

It is clear from the case study evidence that the conditions for this differentiation strategy were not present. Many of the price-sensitive members became disillusioned when the cost of fertiliser and chemicals rose, or rebates could not be paid. There was also insufficient innovation in the new services being provided by UFCC to allow it to command a sustained competitive market position of the larger IOF incumbents.

UFCC could possibly have been sustainable as a low-cost provider of fertilisers and chemicals if they had targeted a niche market that the larger competitors were less interested in. In the process of doing so UFCC should have allowed for retention of profits that would ensure business viability and reduce environmental dependence risks.

UFCC also needed to recognise that their change in strategy impacted on their business model and the MVP that this delivered. Changes of this magnitude require careful consideration and must take the membership base with them, or the purpose of the co-operative will be lost, and members will drift away.

Finally and most importantly there is evidence to suggest that the board was driven by a vision to become a “vertically and horizontally integrated agribusiness giant co-op” (UFCC 2003, p.3). As noted by Mamouni Limnios and Mazzarol (2014):

“In the process of pursuing this vision they a) failed to bring their members along and ensure their trust and support and b) failed to effectively oversee

Co-operative Enterprise Research Unit (CERU)
Losing sight of purpose – The United Farmers’ Co-operative Company

management, review, and adjust decisions that were financially less viable than initially forecasted. This led to the downfall of UFCC.”

THE FINANCING OF UFCC

The United Farmers' Co-operative Company (UFCC) was established in 1992 as a distributing (for profit) co-operative. The firm's Memorandum and Articles of Association declared that members who wished to join had to purchase shares (the original founders each contributed \$1,000 for 10 shares). Members could accumulate shares via trading, but there was a limit on the total number of share that any individual member could hold. The co-operative also adhered to the 'one-member-one-vote' principle of governance.

Members were eligible for rebates and profit distributions, and as a principle, the co-operative aimed to distribute as much of the profits back to the shareholder-members. This would be done either in the form of additional shares, or as cash dividends. The desire was to avoid the co-operative building up or 'hoarding' cash reserves, or 'undistributed wealth'. Any move to have the co-operative demutualised and converted into an investor-owned firm (IOF), was to be made difficult through a provision that it required a 75% majority vote of the membership to change the articles of association or corporate structure.

Rabobank (2011) suggest that a co-operative should have a strong profit margin and aim to retain 50% of the annual profits for ongoing operations and distribute the remaining 50% back to members either as shares or cash dividends on a proportional basis based on volume of patronage. UFCC had low profit margins and a strong focus on maximizing annual rebates. In the early days the rebate was 100% of the profit, 80% in shares and 20% in cash until members reached the share cap and were since entitled to full payment. Board members were aware of the risks associated with the lack of reserve capital but were unwilling to improve the enterprise's financial position at a cost to the farmers' bottom lines (UFCC 2003).

THE CHALLENGES OF BEING A FAST GROWING 'PACEMAKER' CO-OPERATIVE

LeVay's (1983) 'wind-it-up' theory suggests that co-operatives can be dissolved simply because "their initial objectives have been achieved" (LeVay 1983, p.28) as competitors adjust their prices or improve their services. Indeed, in UFCC's case the initial purpose to break the market duopoly and bring down the excessive profit margins that fertiliser suppliers enjoyed was achieved within the first decade of the co-operative's history. This question emerged through the interviews and had been discussed at board level as early as in 1995:

"It met that purpose absolutely [to bring the price down] and the market has been different forever since then. And that debate took place at board level to say maybe it's run its race; have we achieved our objectives? That discussion came up a couple of times."

"It was often, but not always, a question in a strategic planning session so they were conscious of that and I remember it being the case, indeed, it first appeared to my recollection in 1995 when there was no fertilizer imported and still the price was down and the growers knew, most of the marketplace knew that it was because of our actions and more importantly, the threat of our actions... maybe it [the co-operative] should just exist as a threat more than an active participant in the marketplace" (Source: interviews).

According to LeVay (1983) a successful co-operative that can offer highly competitive pricing can also become a 'Pacemaker', able to set prices and help to force competitors to match them. However, as survival becomes important for members, such as the farmers who supported UFCC, they seek a *raison d'être* to maintain the co-operative, one of which may be that:

"The very existence of a successful co-operative makes for greater efficiency amongst the competitors, so that even when price and service adjustments have been effected, the organisation is kept in being to fulfil a pacemaker role" (LeVay 1983, p.28).

There is evidence that co-operatives in many instances set the market floor price (e.g., historically Murray Goulburn in the Australian east coast milk market), a value that can only be appreciated when they disappear from the market and the floor price collapses. The existence of UFCC until 2008 and the subsequent merger with Ravensdown, and farmer anguish over fears of price rises when the latter withdrew from Australia (McConchie and Zonca 2014), provides evidence towards the claim that a 'pacemaker' co-operative in the market ensures that the price is kept competitive to the farmers' benefit.

One of the challenges that co-operatives face when operating as pacemakers is that their members can become disappointed by the small to no price difference, especially when a significant differential has been provided in the past (LeVay 1983). As a result, members can be observed to display low loyalty and trade with competitors for small price benefits, free-riding on the existence of a co-operative that keeps the overall price down. This behaviour can however endanger the longer-term survival of the co-operative.

UFCC seems to have made the transition to a pacemaker in the market, and then lost member loyalty because of their inability to maintain a competitive product offering that satisfied their initial purpose of delivering cost-effective fertiliser to their members. It might be argued that it was not UFCC's success that led to its failure, but its consequent lack of focus and competitiveness in the business of fertiliser and chemicals supply due to an aggressive growth and diversification strategy that was not executed and monitored effectively by the board.

UFCC'S FINANCIAL PERFORMANCE

Table 1 outlines the financial performance and overall trading history of UFCC from its establishment in 1992 until its acquisition by Ravensdown in 2008. The first decade of UFCC's

Co-operative Enterprise Research Unit (CERU)

Losing sight of purpose – The United Farmers' Co-operative Company

history saw it expand rapidly, challenge the two large IOF incumbent competitors, and force down the market price of fertilisers and chemicals.

Table 1: An overview of UFCC's trading history

Year	Activity
1992	UFCC is founded with a capital base of \$5,000.
1993	Record breaking \$1.14 million profit generated in first full-year of trading.
1994	Membership grows to more than 750.
1995	Membership grows to more than 900. Members pay upfront for fertiliser in January but receive it in June.
1996	Membership grows to more than 1,200.
1996/1997	The Bill of Exchange is introduced (later to become direct debit requests), allowing members to make a promise to pay. The co-operative is then able to borrow against this to a maximum of 70% of the Bills.
1997	Bulk storage facility is opened at Naval Base south of Perth and membership reaches 1,400. UFCC turns over more than \$20 million.
1998	Bulk storage facility opens in Geraldton and upgraded to double its capacity later that year. Sales double for the third consecutive year. UFCC pays a record 13.7% rebate (\$5.4 million). Membership rises to 1,756.
1999	Annual turnover increases by 60%. Additional bulk storage facility opens in Esperance. Membership increases to 2,225.
1999/2000	Strong competition and difficult growing season impacts farmers. Fertiliser sales increase by a modest 2.5% and the co-operative pays an 8.5% rebate.
2000	A contaminated cargo of fertiliser on the MV Bara impacts trading and leads to an insurance settlement. Only an interim rebate of 3.18% paid with the balance to be posted upon insurance payout for the contaminated cargo. This balance took place in 2003.
2001/2002	UFCC begins to experience financial problems and the chairman announces plans to raise additional capital and close the co-operative to non-members.
2003	Annual sales turnover of \$94.6 million generates an operating profit of \$8.6 million. Dividends of \$17,000 and rebates of \$2.2 million are paid.
2004	Annual sales turnover of \$121.5 million generates an operating profit of \$5.5 million, final net profit is \$33,000. Dividends of \$11,000 and rebates of \$5.4 million are paid.
2005	Annual sales turnover of \$117.9 million generates an operating profit of \$3.2 million, final net loss is \$121,000. Dividends of \$10,000 are paid but no rebates.
2006	Annual sales turnover of \$135.9 million generates an operating loss of \$1.9 million, final net loss is over \$3.6 million.
2007	Annual sales turnover of \$92.8 million generates an operating loss of \$7.98 million and a final net loss of \$15.98 million.
2008	Ravensdown NZ acquires UFCC for an undisclosed sum.

Sources: UFCC (2001; 2003; 2004; 2005; 2006; 2007)

By the end of that decade UFCC was riding high:



“The 1998-99 year had been another record year -- the fourth in succession -- for UFCC with total revenue of \$67 million up by 60 per cent on the previous year. A trading surplus of \$6.9 million had enabled the Board to declare a 10.3 per cent trading rebate. Almost \$4.2 million of this surplus was rebated in shares and most of the balance distributed in cash to eligible shareholders. Fertiliser sales had been particularly strong – 64 per cent better than the previous year, with more than 100,000 tonnes sold before Christmas 1999” (interviews).

“The Co-operative also now had significant assets in land and buildings and the number of shareholders rose by 469 to 2,225, mostly from the Esperance and other southern areas of the State. This growth was mainly due to the completion of the Esperance storage facility which had been opened in February 1999 by the then Minister for Transport, Murray Criddle. Already, more storage space had to be added to the Esperance facility and the building of a store at Albany was underway” (interviews).

However, the tide turned by the turn of the new century with changing market conditions and the impact of several years of drought that negatively affected farm production:

“Difficult seasonal conditions in 1999-2000 and strong competition halted the co-operative’s run of record years. Fertiliser sales increased by a modest 2.5 per cent in a competitive market but reduced global prices and a reduction in local prices resulted in a lower total revenue of \$59 million, \$8 million less than the previous year. A trading surplus of \$4.5 million yielded an 8.5 per cent rebate though final payment of the rebate was subject to a satisfactory insurance settlement. Rod Madden reported: ‘While these results are down on last year, the return on share capital of 31.7 per cent is an exceptional result’” (interviews).

As shown in Table 1, the co-operative’s financial performance declined steadily over the period 2002-2007 with slowing sales growth and declining profits. This resulted in UFCC being unable to pay rebates, and eventually dividends. The diversification and growth strategy that UFCC had embarked upon during the time of CEO Tony Usher had led to increasing operating costs, at a time when the market was turning down.

The “back to basics” turnaround strategy implemented by the new board led by Chairman Bowe Wilson came too late and by the time of the 2007 annual report, UFCC had already opened discussions with Ravensdown. In his summary of the financial problems facing UFCC, Wilson explained that drought conditions across the WA wheat belt had been protracted for a second season resulting in failed crops. Simultaneously there had been a significant rise in farm input costs as global investment in bio-fuels had seen an increase in the cost of fertilisers.

In announcing the poor financial performance of the co-operative, Wilson noted that:



“As foreshadowed in correspondence to you in October, dry weather conditions inevitably hurt United Farmers’ business with lower than anticipated sales of fertiliser and chemicals. High fertiliser prices meant that fertiliser shipments demanded more of the Co-operative’s balance sheet than was practicable. Significant progress made to reduce costs and return to profitability under our ‘Back to Basics’ program (including the removal of approximately \$6 million in costs annualised from warehousing, salaries and wages, logistics and other areas) were overshadowed. Consequently, United Farmers has recorded a net operating loss before tax for the year of \$7.98 million and rebates will not be available to shareholders. The net loss after writing down the Company’s assets as a consequence of the merger transaction is \$15.98m” (UFCC 2007).

He also went on to make the following observation:

“In October 2006, the Board established a Strategy and Planning Committee to reconsider strategies of the past and to chart a course that would provide low-cost farm inputs for shareholders well into the future. It was evident from the Co-operative’s balance sheet that a significant capital injection was required to meet these aims and in July 2007, the Board appointed PricewaterhouseCoopers to find potential options for raising equity capital...After long, thorough consideration including an assessment of the risks and opportunities under each option, your Board unanimously agreed to enter exclusive discussions with New Zealand’s Ravensdown Fertiliser Co-operative Limited to progress a merger of the two businesses, while maintaining the United Farmers name in Western Australia” (UFCC 2007).

THE GOVERNANCE CHALLENGES OF UFCC

In this final section we examine the governance of UFCC, and highlight the decision making within the co-operative’s boardroom, and the eventual divisions that occurred within the board as the firm’s financial situation deteriorated.

THE IMPORTANCE OF GOOD GOVERNANCE

Leadership and good governance are essential to the success of any business enterprise. However, the co-operative and mutual enterprise (CME) provides a particularly challenging environment with studies highlighting poor governance as one of the key weaknesses facing such businesses (Birchall and Simmons 2009).

The role of a board of a co-operative is not only to ensure the efficient operation of the business, but to ensure that the overall purpose for which the enterprise was created is fulfilled, and the ‘cooperative identity’ of the organisation preserved (Othman, Mohamad, and Abdullah 2013).



“In a manner of speaking, an indifference to the affairs of the co-operatives indicates members do not engage themselves in the operations and management of cooperatives, opting to leave the matters to the management to make decisions as deemed fit to their intentions” (Othman et al. 2016 pp. 8-9).

The United Farmers’ Co-operative Company (UFCC) was established in the early 1990s to address a market failure and help lower the cost of fertiliser and chemicals to grain producers in Western Australia; at a time when the market was dominated by two large investor-owned firms (IOFs), Wesfarmers CSBP and Sumitomo.

Despite a very promising start, UFCC quickly found itself a victim of its own success. It shifted from a ‘no-frills’ low-cost producer, to a ‘full-service’ differentiated business, but this strategy of diversification proved challenging for the co-operative’s board and management.

Even from the early days some board members had strong views on the type of business UFCC should diversify in. This was based on their own professional background and pressure from growers in their local area:

“Lindsay Olman was very passionate about machinery, Phil Patterson came with a very strong view that they should get heavily involved in agricultural chemicals, and Alan Winney had his own grain business in the east... [He] was very much a part of that push into the grain.” (Source: interviews)

In addition to overextending themselves in trying to develop expertise in multiple industries simultaneously, the management of UFCC often failed to undertake thorough due diligence, making assumptions of volume for the various business units that did not materialise. For example, they estimated that they could:

“...buy grain for cash from members and sell it and make a \$5 margin [per tonne] and at the end of the day that \$5 margin proved to be somewhere between about 30 and 50 cents.” (Source: interviews)

It seems that the board and management somewhat naively thought that as they were very good at supplying farm inputs they would be equally able to:

“...do a better job at grain marketing, wool marketing and providing [agronomic] expertise than anybody else in the market. And over time that proved to be wrong.” (Source: interviews)

THE FOUNDATION OF UFCC

The co-operative's Memorandum and Articles of Association were registered on 8 July 1992. After a particular farmer unexpectedly declined an invitation to become a director at the eleventh hour without informing the rest of the group, the founding directors were Madden, Johnson, Mullewa farmer Lindsay Olman, Wannamal farmer Malcolm Taylor and Brindal, who was appointed instead of a fifth farmer.

Each contributed capital of \$1,000 and was allocated 10 shares each. Madden, Johnson, Olman, and Taylor were all office-bearers or senior members of the Rural Action Movement (RAM). Two weeks earlier Olman had told the rural newspaper *Countryman*:

"Excessive profits are being made from certain farm inputs and once farm produce leaves the farm gate, we have very little, if any, control over the price we receive for it. RAM has seen it necessary to form the United Farmers Co-op to reduce our costs and where possible sell our produce for maximum return."

The first meeting of the co-operative's board was held at the Morawa Shire Council offices on 24 July 1992. Madden was nominated, and elected, as chairman. Kalannie farmer Rawley Lang and Nyabing farmer Lloyd Young were invited to attend on the basis that they would become directors once the co-operative was incorporated. They became directors in October that year.

It was decided that United Farmers would be a non-aligned, non-political organisation. United Farmers and RAM would proceed along separate but close parallel lines. However, the UFCC directors were there to represent shareholders. The politics could be left to RAM. The directors agreed that the range of the co-operative's activities would grow to provide a wide band of services even though it would start from a small base.

The Co-operative was structured so that each shareholder had one vote. The directors also agreed to place a limit on the number of shares any one person could hold and to distribute as much of the profit as possible back to the shareholders in the form of shares and cash to eliminate the hoarding of "undistributed wealth." It also required a 75 per cent majority vote to change the articles or convert to a company. These four issues combined to make it almost impossible to convert to a company structure, virtually preventing it ever becoming a takeover target.

GOVERNANCE FAILURE

UFCC's board members were commonly characterised by strong passion and dedication to the organisation and the co-operative value of self-help, sharing a vision of a better future for WA farmers. They put in admirable effort for little reward, at times spreading their resources thinly between managing their own farm and the co-operative. Member appreciation in the early days led fellow-farmers to at times work the founding directors' land, as they had to travel to Perth to support UFCC. However, the company grew fast, and the governance processes did not mature as they might have over a longer period.

However, the experience of running the co-operative was not all plain sailing. As one of the founder directors later observed:

“Here was a group, very successful at farming enterprises, applying themselves to corporate and commercial issues and discovering there was a lot more involved than they probably originally envisaged”.

CEO turnover

The lack of corporate management experience at board level led to an inability to recruit, retain, and effectively direct and supervise the right person in the position of CEO. UFCC turned over six general managers/CEOs in eleven years. As founder director Rod Madden explained:

“We had a business but no-one to run it. Max said: ‘We’ve got to keep going, we’ve got to put someone in here to answer the telephone.’ The then secretary of RAM, Mary Anne Rakich, suggested a friend of hers, Lorene Lathbury, who became the co-operative’s second manager. Lathbury had no previous experience in a rural company but with Nixon back organising the procurement and Jones the shipping, her main job was to take orders from farmers”.

In each case the new executive was greeted with early enthusiasm by the board, but this would soon be followed by a break down in the relationship for various reasons. Several cases were related to a break down in trust due to concerns over the way that CEOs were operating, including the transparency of their use of corporate resources and their relationship with board members. In other cases, the business just outgrew the abilities and skills of the directors who were unable to deliver on the strategy set by the board.

The CEO appointment process was not rigorous in the early years, relying on word of mouth without any advertising or competitive selection process. However, in later years an agency was used, and despite the limited number of candidates there was a structured recruitment process. For example, the appointment of their first General Manager Ian Barnden-Brown was a relatively informal process. As one of the former UFCC directors explained:

“Barnden-Brown left CSBP when an opportunity arose to set up an agricultural investment trust for the person he had previously worked for in Esperance. However, after two years of putting the structure in place rural commodity prices crashed, the trust project was shelved, and Barnden-Brown began doing some consulting work. His introduction to Madden and Johnson came through Phil Nixon who he knew through involvement on the Business Migration Panel”.

In 1992 Barnden-Brown had written a letter to Max Johnson saying that if he wanted the organisation to grow he might be interested in some corporate planning sessions to map out a path for the future. He wrote:

"The skills and experience I have in finance and administration were all gained in the context of the rural sector, and I would be pleased to apply what I can to your cause."

After the departure of the first General Manager John Read, the co-operative advertised for a new manager, but the board considered the applications unsatisfactory. Barnden-Brown had not applied for the job because UFCC was heavily involved in the Robb Jetty project, and he was not interested in that issue. As Barnden-Brown later explained:

"When Max asked me why I didn't apply for the job I said: Well, if you guys are going into the meat business, count me out."

Eventually, however, Barnden-Brown was asked if he was interested in the job. By that time, the meat project was dead, Barnden-Brown had gained an understanding of how the company worked through his consultancy work with the co-operative and he accepted the position as general manager in July 1994. His experience with CSBP and other agribusiness firms meant that he felt he had a good understanding of what UFCC needed to do going forward:

"I had pretty firm views on what the co-operative should, and shouldn't, be doing. Then the work began from changing it from essentially a bunch of farmers importing fertiliser to a business organisation" (Barnden-Brown).

Nevertheless, the lack of professionalism in the relationship of board members with the chief executive emerged as a major concern of interviewees. At times the relationship was too close, board members reportedly 'over-socializing' with their CEO, and the CEO approaching individual board members to get their support prior to bringing items to the board's attention. The opposite also took case, where relationships between the CEO and the board or chair would deteriorate dramatically.

These synergies or clashes at personal level seem to have influenced the ability of the board to professionally review and enquire over management reports. At times the board would micro-manage the business, with lengthy debates over small expenditure and other items encouraged by the belief that board member quality was dependent on the number of questions they asked at each meeting.

During other periods healthy debate and questioning of management reports was strongly discouraged, and the board members asking the questions would be regarded as "unnecessarily untrusting". The board was proven unable to establish the appropriate level of enquiry and would

Co-operative Enterprise Research Unit (CERU)

Losing sight of purpose – The United Farmers' Co-operative Company



either micro-manage the business or fail to develop the appropriate understanding of business plans and take control of the direction of the business.

Goal setting process

The inability of the board to effectively control the progress of the implementation strategy, especially in the period of CEO Tony Usher, was partly due to an immature goal setting and assessment process. Proposed business models, budgets and investment opportunities were based on forecasting. As one former director explained, when the forecasted turnover and budgets did not materialise:

“Instead of focusing on where they were going wrong, they would say, hang on a minute, our turnover has increased by 50%, when they budgeted for 80% increase” (source: interviews).

Instead of identifying worrying trends of increased overhead costs early and trying to address that, management was allowed to focus on a smaller number of KPI’s:

“What Usher [the CEO] was saying is that we have got a level of dissatisfaction in our members and what we need to do is have that as a KPI. What he was doing, to meet their expectations, was provide a free service for argument’s sake, soil testing or whatever they wanted. He would throw money at them in order to achieve that KPI. But in the meantime, the other KPIs are getting blown out the window. But he would bring this KPI along and say, oh, gee the shareholders think we are wonderful. They thought that we were wonderful until the end of year results came in and they didn’t have a rebate” (Source: interviews).

Another view that emerged was that the board was not communicating effectively with the CEOs and was over-riding them in setting goals that were not substantiated with the appropriate research, which then the CEOs were not able to achieve and were blamed for:

“[The board would say] the forecasts aren’t being met and indeed the forecasts were being set by the board without any regard necessarily to the CEO (you can see the disconnect) rather than being bottom up with that... [They would say] but we have to grow 20% on last year; we have got to be able to do that; we have got all these people; why can’t we do that” “[Barden-Brown] tried [to put some data together to show to the board what could be done] many times but eventually just got worn down and indeed that was not too dissimilar for Tony Usher; he went through the same process.” “Management was saying this is really stretching the system [diversification] and Tony’s view was: this is my job; I have to start; I have to diversify into these other areas; that’s my brief. He said I am going to be judged by this” (Source: interviews).

Board members

When it comes to the quality of board members UFCC is initially not dissimilar to many other co-operatives that recruit board members solely from the member-base. However, from as early as 1993 UFCC invested in director education programs. It later became a requirement that all board members sat the Australian Institute of Company Directors course, although there was no requirement to pass the examination. UFCC did not have any non-member directors, however independent advisors with special expertise (e.g., finance) were appointed to the board from 1998 onwards (without voting power).

Despite increased level of training the board had difficulties defining what constitutes conflict of interest at board level. In any co-operative member directors have business transactions with the co-operative; they are however called to adhere to their fundamental directorship responsibility of making decisions with the interests of the organisation of which they are a director as their primary concern. The challenge was that some of the board members were not ordinary transacting members. There were two directors who were UFCC agents receiving sales commissions (and thus had an interest in maintaining the provision of certain products and services) and another director who was the owner of a wheat company from the eastern states of Australia that was transacting with the co-operative in large volumes and had an interest in maintaining UFCC's involvement in the wheat industry. Indicatively, in 2006 one director sold farm outputs to the co-operative for the value of \$5.055 million, when all other directors sold outputs in the range of 0 to \$164,406 (UFCC 2007).

As noted earlier some board members came with a passion in a certain industry or product and strategies were in some cases personality driven. Although there were strong personalities on the board, the board was at times too weak to decide to drop an idea and move on.

"At one stage 12 different projects were on the directors' agenda...in September 1996 I introduced the concept of high-level criteria to use as a 'drafting gate' for new projects...we assessed each project against the criteria. Only one passed (a grain project) ...within six months they [the projects] were all back there" (source: recollections communicated to authors in writing).

"I saw most of the strategies that we talk about here kept limping along. I said, kill it, kill it. To me the board was too weak to make strategic decisions" (source: interviews).

PROPERTY RIGHTS AND AGENCY THEORIES

The agency and property rights theories suggest that the co-operative business model is prone to challenges and inefficiencies due to the separation of ownership from control and due to poorly defined property rights that lead to conflicts over residual claims and decision control. These challenges are theorised to emerge progressively when the co-operative has managed to correct the market and has assumed a pacemaker role, in which case transaction costs become more important, professional managers are brought in and ambitions for growth emerge.

Cook's (1995) life cycle theory suggests that at that stage the co-operative will either a) exit either through liquidation, a merger with another co-operative or a transformation to an investor-owned firm (the latter for the more successful co-operatives); b) continue as a co-operative but seek external capital or pursue a proportionality strategy of internally generated capital; or c) shift to a hybrid structure such as a 'New Generation Co-operative' (a co-operative structure that allows for share appreciation, increases share liquidity and eliminates external free riders).

UFCC entered the third stage of Cook's (1995) life cycle theory in the early 2000s as it had successfully corrected the market, started to become increasingly complex and scrutinized by members. However, property rights and agency theories may not be sufficient to explain the historical evolution of UFCC from that point onwards.

UFCC did not experience portfolio and horizon problems despite poorly defined property rights. Free-rider concerns were minor as indeed the co-operative traded with non-members. However, this did not impact on its viability. Although the co-operative's attempt to diversify was unsuccessful, this was not due to the typical emergence of influence cost problems, where different groups of members have differing selfish interests and thus attempt to influence decision making to their benefit (Cook 1995).

There was an overthrow of authority at the 2006 AGM, which was due to members' concern over higher operational costs and the strategic direction and future of the co-operative, rather than a result of member heterogeneity and self-interest. Similarly, there is some indication of the emergence of control problems caused by difference in opinions between board members and management (CEO), which intensify in 2003, leading to the resignation of the chairman and two board members in 2004.

There is a view amongst many of the former UFCC directors that the CEO at the time, Tony Usher, was a strong driving force for diversification and vertical integration. However, there is evidence that this agenda was passed on to him from the board, which appointed him to deliver on diversification. The two previous CEO's unwillingness or inability to pursue an aggressive diversification strategy was partly what led to their replacement.

There is also evidence from board meeting notes that the board collectively pushed for diversification for four years, with concerns arising only in 2003. When disagreements over diversification and management practices took place, most of the board was supportive of management initiatives and remained so until 2005. This does not suggest a typical manifestation of the control problem, rather a difference in opinion over the co-operative's strategic direction between some board members and the remaining board members and the CEO.

UFCC was a very entrepreneurial co-operative. Most co-operatives are conservative as horizon and portfolio problems can discourage differentiation and the pursuit of entrepreneurial opportunities. As a result, they commonly remain focused on delivering a single purpose, which can lead to success, but can also lead to failure if member base shrinks or the purpose is no longer relevant. The board of UFCC identified early on the inherent weaknesses of their business model, their inability to reach large farmers, and their high environmental dependences and made it a priority to "drought proof" their business. UFCC was in that regard proactive in introducing

management and structural changes, whereas many co-operatives are reactive to change. Board members were entrepreneurial and innovative, introducing external advisors to the board and the provision of innovative fertiliser blends and agronomist advice, both of which are now a norm in the industry.

LeVay (1983) argues that the birth of agricultural co-operatives has often been almost immediately succeeded by their demise. Something she suggests may be due to:

“a lack of appreciation on the part of farmers of the risks involved in forward integration”

That may have been the case for UFCC, as both board and management were engrossed in their strategic drive for growth and diversification that they failed to see the impact on their operational costs and member loyalty. As members started to perceive their patronage relations with the co-operative as not very rewarding they lost trust in management. A couple of bad seasons where low volumes further increased operational costs prevented the success of their “back to basics” program which evidently came too late.

KEY LESSONS FROM THE CASE

The key learning for this case is that any strategy can fail if it is not appropriately executed, communicated, and valued by members. For a co-operative the question should be;

1. will existing members value the added purposes and benefit from them directly, or
2. will the co-op attract new members for these new purposes and through economies of scale be able to benefit existing members indirectly?

If there is sign that neither of the two is materialising then the diversification strategy is likely to fail. These are fundamentals to strategic management and co-operatives should not ignore the realities of their business model any more than should the directors of IOF. Good strategy requires an understanding of the conditions of the industry or market and the basis upon which a sustainable competitive business model is to be built. The design of a competitive business model requires the co-operative to focus on its purpose and the elements that comprise its MVP. It must listen to the voice of its members in the same way that an IOF must listen to the voice of its customers. Hubris and over optimism can create dangers for any business. Yet disunity and division within the board and senior executive levels is calamitous.

UFCC lost members support and trust as the projected economies of scale did not materialise. Instead of shutting down early some of the unsuccessful investments UFCC became obsessed with growth, losing sight of purpose, that they were there for their members and needed to provide member value both in the short term and long-term.

REFERENCES

- Beyer, M. (2008). "\$6m United Farmers Sale", Business News Western Australia, 23 January.
- Birchall, J. (2011). *People-Centred Businesses: Co-operatives, Mutuals and the Idea of Membership*. London, New York, Palgrave MacMillan.
- Birchall, J., and Simmons, R (2009). *Co-operatives and Poverty Reduction: Evidence from Sri Lanka and Tanzania*. Oldham, Co-operative College.
- Byrne, N., and McCarthy, O. (2014). Value proposition preferences of credit union members and patronage activity. *The International Journal of Bank Marketing*, 32(6), 589-567.
- Cattle, T. (2013). Ravensdown sale confirmed, *Farm Weekly*, www.farmweekly.com.au 25 September.
- Cook, M. L. (1995). The Future of U.S. Agricultural Co-operatives: A Neo-Institutional Approach. *American Journal of Agricultural Economics*, 77(5), 1153-1159.
- Co-operatives WA (2008) "Co-operatives WA News", June.
- DAFWA (2009) *Western Australian Farm Inputs Taskforce Report 2008*, Perth, Department of Agriculture and Food, Government of Western Australia.
- Farm Weekly (2013) "Ravensdown looks to sell its WA arm", Farm Weekly, www.farmweekly.com.au 11 July.
- Hinkley, B. (2014) "Payment delay angers shareholders", Farm Weekly, www.farmweekly.com.au 28 March.
- LeVay, C. (1983). Agricultural Co-operative Theory: A Review. *Journal of Agricultural Economics*, 34(1), 1-4.
- Madden R., Dempster, V., and Chamberlain, I. (2004) "Resignation letter to shareholders", unpublished.
- Mamouni Limnios, E. A., Mazzarol, T., Soutar, G. N., and Siddique, K. H. (2018). The member wears four hats: A member identification framework for cooperative enterprises. *Journal of Co-operative Organization and Management*, 6(1), 20-33.
- Mamouni Limnios, E. and Mazzarol, T (2014). Losing sight of purpose – the United Farmers' Co-operative Company, in Mazzarol, T., Reboud, S., Mamouni Limnios, E. and Clark, D., *Research Handbook on Sustainable Co-operative Enterprise: Case Studies of Organisational Resilience in the Co-operative Business Model*, Cheltenham, UK, Northampton, USA, Edward Elgar Publishing, pp. 249-270.
- Mazzarol, T., Mamouni Limnios, E., and Reboud, S. (2013). Co-operatives as a Strategic Network of Small Firms: Case studies from Australian and French Cooperatives. *Journal of Co-operative Organization and Management*, 1(1), 27-40.
- Mazzarol, T., Simmons, R. and Mamouni Limnios, E. (2011). *A Conceptual Framework for Research into Co-operative Enterprise*. CEMI Discussion Paper Series DP 1102 (Centre for Entrepreneurial Management and Innovation): [available online] <http://cemi.com.au/node/249>.
- McConchie, R., and Zonca, C. (2014) "Fertiliser company shuts Queensland operations", ABC News Rural, 16 May.
- Morrison, T. (2013) "Ravensdown shareholders miss payout", News.com.au 15 August.
- Murray, A. (1988). A Contingency View of Porter's Generic Strategies. *Academy of Management Review*, 13(3), 390-400.
- Nilsson, J. (2001). Organisational Principles for Co-operative Firms. *Scandinavian Journal of Management*, 17(3), 329-356.



-
- Othman, I. W., Mohamad, M., and Abdullah, A. (2013). Cooperative Movements in Malaysia: The Issue of Governance. *International Scholarly and Scientific Research & Innovation*, 7(6), 1488-1492.
- Othman, R., Embi, R., Aris, N. A., Arif, S. M., Choo, H. C., and Ismail, N. (2016). Board Governance and Performance: An Exploratory Study of Malaysian Cooperative Organizations. *Journal of Southeast Asian Research*, 2016(1), 1-2.
- Porter, M. E. (1981) The Contribution of Industrial Organisation to Strategic Management, *Academy of Management Review*, 6(4), 609-620.
- Porter, M. E. (1991). Know Your Place: How to Assess the Attractiveness of your Industry and your Company's Position in it. *INC.*, 13(9), 90-93.
- Rabobank (2011) Interview with Rabobank senior global client services managers, Utrecht, unpublished.
- RNZ (2013) "Ravensdown in talks to sell WA fertiliser operations", Radio New Zealand, 11 July.
- Suter, P., and Gmur, M. (2013). *Member value in co-operatives. Switzerland*, Université de Fribourg Working Papers SES No. 444.
- UFCC (2001) Annual Report, United Farmers' Co-operative Company Ltd.
- UFCC (2003) Annual Report, United Farmers' Co-operative Company Ltd.
- UFCC (2004) Annual Report, United Farmers' Co-operative Company Ltd.
- UFCC (2005) Annual Report, United Farmers' Co-operative Company Ltd.
- UFCC (2006) Annual Report, United Farmers' Co-operative Company Ltd.
- UFCC (2007) Annual Report, United Farmers' Co-operative Company Ltd.
- Warren, D. (2002) Ten X Years: A Decade of Growing Success Against the Odds, United Farmers' Co-operative.
- Webb, T. (1996). Marketing the Co-operative Advantage. *Journal of Co-operative Studies*, 87(2), 10-15.



About the authors:

Elena Mamouni Limnios is an Assistant Professor at the University of Western Australia. Her primary research interest lies in the field of complex systems management with a particular emphasis on corporate systems, cooperative enterprises, and market applications. She focuses on the development of theoretical models, quantitative assessment methods, and management practices. Her research has a strong applied component, through case study analysis at the socio-ecological and corporate scales, including resilience indicators development and testing, complex systems behaviour classification and forecast, product ecological foot printing and policy development. She holds a PhD from the University of Western Australia, an MBA with distinction from the American College of Thessaloniki (Greece), and a Diploma in Engineering with high distinction from the Aristotle University of Thessaloniki in Greece.

Tim Mazzarol is a Winthrop Professor in Entrepreneurship, Innovation, Marketing and Strategy at the University of Western Australia and an affiliate Professor with the Burgundy School of Business, Groupe ESC Dijon, Bourgogne, France. He is also the Director of the Centre for Entrepreneurial Management and Innovation (CEMI), an independent initiative designed to enhance awareness of entrepreneurship, innovation, and small business management. He is also the founder Director of the Co-operative Enterprise Research Unit (CERU), a special research entity for the study of co-operative and mutual enterprises (CMEs) at the University of Western Australia. In addition, he is a founder Director and Company Secretary of the Commercialisation Studies Centre (CSC) Ltd., a not-for-profit mutual enterprise focused on advancing best practice knowledge of commercialisation. Tim is also a Qualified Practising Researcher (QPR) as recognised by the Australian Research Society (ARS). He has around 20 years of experience of working with small entrepreneurial firms as well as large corporations and government agencies. He is the author of several books on entrepreneurship, small business management and innovation. He holds a PhD in Management and an MBA with distinction from Curtin University of Technology, and a Bachelor of Arts with Honours from Murdoch University, Western Australia.