

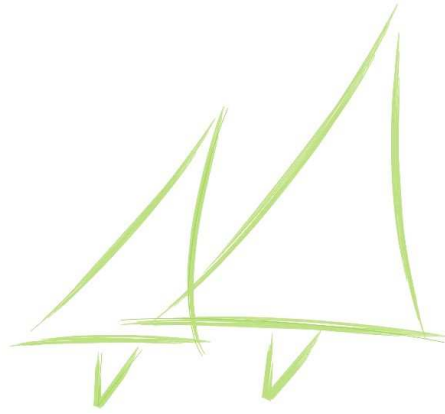
V ENCONTRO DE PESQUISADORES LATINO-AMERICANOS DE COOPERATIVISMO

V ENCUENTRO DE INVESTIGADORES LATINOAMERICANOS DE COOPERATIVISMO

MOVIMENTO COOPERATIVO, TRANSNACIONALIZAÇÃO
E IDENTIDADE COOPERATIVA NA AMÉRICA LATINA

MOVIMIENTO COOPERATIVO, TRANSNACIONALIZACIÓN E IDENTIDAD COOPERATIVA EN AMÉRICA LATINA

COMITÊ DE PESQUISA DA ALIANÇA COOPERATIVA INTERNACIONAL



076 - CAPITAL STRUCTURE INNOVATION TO EXPLOIT GROWTH OPPORTUNITIES IN THE GLOBAL DAIRY SECTOR: THE CASE OF CONAPROLE

Eficácia e eficiência da empresa, inovação e experiências
na integração cooperativa

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Abstract

After a brief descriptive history of Conaprole and its inception as a semi-statal organization, we utilize a microanalytic property rights approach to demonstrate how Conaprole's radical process of internal reorganization served to ameliorate the alignment of preferences amongst producers and the cooperative.

We examine the transformation of Conaprole from a state-directed enterprise to the largest dairy exporter in Latin America by tracing the establishment of residual control and residual claimant rights, a distinct paradigm for the relationship between the member and the cooperative, and new pricing mechanisms that allow the cooperative to more effectively construct selective incentives. The theoretical significance of these organizational innovations is assessed. In addition, we discuss Conaprole's experience in terms of the practical implementation of changes to their cooperative structure. We concentrate on assessing the implementation of capital structure innovations by discussing valuation of the cooperative enterprise, producer payments, risk capital generation, and integration of the producer into the global value chain.

To conclude, we consider the governance challenges that lie ahead for Conaprole. In addition, we present a conceptual framework that allows cooperatives to assess the evolution of their organization and harmonize governance structure with a chosen market strategy.

Key-words: Capital Structure, Parastatal, Restructuring

A truck arrived one afternoon at Don Anselmo's dairy farm driven by a young man introducing himself as a technician from a private firm. He approached the owner confidently, complimenting the owner on his well-run operation, and asking him whether he would like to do business with a private firm. The young technician offered a 10% premium over cooperative milk prices and assured the owner he would not be hassled over the quality of milk received. The owner's son, having listened intently to the conversation without saying a word, hurried to question his father as soon as the visitor left. "Dad, what are you going to do? That is a lot of money. With those milk prices we could invest in a new milking parlor."

Milk Markets Threaten to Sour as Monopoly Power Expires

The National Cooperative of Milk Producers (Conaprole), a cooperative organized by the Uruguayan government in 1936, was entering into a new era. For the first 50 years of their charter, Conaprole was granted monopoly power over the fluid milk industry in Montevideo in order to ensure stable milk collection and supply of fluid milk for the city. Upon the expiration of this fifty-year term, Conaprole came face to face with fierce competition from a newly-formed firm, Lactería.

Lactería, an investor-owned firm, looked to position itself to compete with Conaprole for local market share. It had in its favor the advantage of being able to select its producers. They targeted producers with sufficient volume and prime locations for collection to reduce their marketing margins. Low volume producers were not selected. As Lactería found more attractive suppliers, they simply communicated to smaller producers that they would no longer be collecting their milk.

Origin Constraints

The cooperative, despite the expiration of their monopoly power, was obligated by its legal charter to receive milk from all producers. Producers from any part of the country could become a member of the cooperative. In addition, the cooperative had to comply with federal quota regulations regarding the domestic supply of fluid milk for human consumption.

Producers interested in buying additional quota rights due to increased milk production were required to buy quota rights from fellow cooperative members. The exchange of quota was governed by a cooperative board. The same was necessary if a new producer wanted to begin production. New producers received a sixty-liter quota, additional delivery rights had to be purchased depending upon the producer's forecast of production capacity and future market prices. The potential for significant price differentials existed between domestic and international markets, making this an important consideration. Excess production generally had to be sold on international markets which offered lower milk prices than domestic markets. Quota rights, which constituted patronage rights, began to lose value due to the liberalization of the milk monopoly. This, in turn, left a political vacuum because the possession of quota rights were linked to voting rights in the cooperative.

Lactería instituted differential payments to suppliers, permitting them to engage in negotiations with individual producers. On average, Lactería was able to offer ten percent higher milk prices to producers, but without a long-term commitment to continue milk purchases. The legal framework approved in 1984 did not require private firms to uphold a common price while the cooperative was required to do so due to their pre-existing structure held over from their days of monopoly power. When Lactería sold its assets to a multinational corporation, Parmalat, the milk market turned even more aggressive.

The cooperative was faced with a relentless loss of producers, as well as tough competition for raw materials and local market share. Competition almost turned destructive as Parmalat, and later other firms, surprised the market with uncommon market practices such as delivering bakers' dozens to retail outlets or offering special commercial and distributor discounts.

Preserving Cooperative Unity

In this environment, the sustainability of the cooperative was threatened not only due to price differentials, but by also by a new generation of producers that perceived the cooperative as inefficient. Some of the challenges Conaprole faced were a direct consequence of the restrictions imposed on the organization by its founding legal framework.

Many producers saw small increases in their milk payments from Conaprole. These producers attributed increases in milk payments to increases in competition and remained loyal to the cooperative. However, as private firms began to offer higher milk payments to producers, a significant portion of cooperative members began selling their milk to private firms. The price differential widened. And, their loyalty was lost to the highest bidder. It turned out to be easy for farmers to accept the risk of supplying private firms because they were able to return to the cooperative as a last resort. In this complex environment the cooperative searched to define a defense strategy.

Production Contracts Instituted to Ensure Cooperative Viability

A five-year member contract was established to stabilize a development and adjustment process over the next few years. These contracts ensured sufficient milk supply to complete a series of investments that were at risk due to falling milk deliveries. Without a stable milk supply, processing levels could not be met to recuperate investments in new facilities which were underway. The decision to generate contracts was met with great resistance on the part of many producers. Some producers believed the cooperative was bowing to competitive pressure, others saw no need for contracts because they considered themselves loyal members, still others suspected the worst.

Union representations and various producers actively participated in a lengthy contract negotiation process. Some producers withdrew from cooperative membership during the process. Amidst doubts, they preferred the profits private firms were offering. Negotiations began in 1995, but contracts were not

signed until 1996. Marked changes were then instituted in the operation and structure of the cooperative. Management was changed as a process of modernization while restructuring began.

Financial Market Instability

The period was characterized by strong markets in the region, primarily due to the Real Plan instituted in Brazil in 1994, which stabilized the economy and generated strong demand and sustained prices. The creation of Mercosur in 1995 strengthened this trend and fostered export markets. Among the firms that benefitted was Parmalat, which operated several plants in the region that facilitated the balancing of production and production of related products. This situation generated a good export climate and sustained production growth. Conaprole was able to invest, as planned, in a new dry milk powder plant. In addition, Conaprole increased their production capacity for extended-shelf life milk which was exported daily to Brazil through simple, financially convenient distribution mechanisms.

Nevertheless, disturbing signs were on the horizon. In 1997, the Asian Tigers, which had served as an example among developing countries, entered into financial crisis. Financial crises in Mexico and Russia soon followed suit. International commerce entered into a downward spiral. In 1999, Brazil devalued the Real. Intermittent losses due to exchange fluctuation resulted in a significant decline in milk exports to Brazil and the unleashing of a deep crisis. Seventy percent of Conaprole's exports had been directed toward Brazilian markets. International demand and market prices now fell to abnormally low levels.

The cooperative directors faced a tough decision. They voted to reduce domestic milk payments. This generated great discontent among the producers. Meanwhile, Argentina had stabilized their economy by pegging their exchange rate to the dollar. Thus, Argentinian milk demand was stable. Taking advantage of this situation, the Exxel Group made an offer.

Corporate Takeover Attempt

The Exxel Group represented a group of investors interested in buying the Conaprole brand as well as its domestic and international businesses. They made an offer comparable to Argentine prices and attempted a shareholder buyout. Negotiations were carried out through direct invitations to individual members. Exxel invited members to upscale facilities and presented favorable projections to convince members of the benefits they would receive upon the sale of Conaprole. A great debate arose among those who wanted to sell and those members who wanted to preserve the cooperative structure. Many cooperative members had yet to understand the depth of the coming challenge.

Cooperative Valuation and Ownership

The Exxel offer had one positive impact. It assigned value to the cooperative. A seed was planted. Members began to recognize the cooperative had value. No one knew quite what the cooperative was worth, nor how to determine its value.

But, it must have value if someone was offering to buy it. The most shocking realization, when considering the sale of the cooperative, was that no one was quite sure who the owners were.

Up until this time, member contributions consisted of a three percent retain on milk payments. These membership retains constituted allocated member equity, redeemable by the member at the discretion of the Board or upon exiting the cooperative. This government-organized entity had not entirely defined members' financial participation in the cooperative. This question had simply never been considered despite the cooperative's long history.

Conaprole began discussing how to respond to competitive buyout offers. These discussions were facilitated by an international consultant that evaluated offers from a number of potential buyers. However, none of the offers were tempting enough for the cooperative to enter into serious negotiations with prospective buyers. Discussions of the sale of the cooperative were dropped. And, the focus turned toward internal restructuring of the cooperative.

Internal Capital Structure Reorganization

Conaprole began to change its patronage structure. Patronage refunds were high despite low milk prices received by the cooperative. Therefore, members had very little equity in the cooperative. A new framework was needed as the cooperative sought to reach a compromise through patronage contributions.

The new governance framework established was named the productivity fund. This fund was established through member retains but incorporated a new component that would serve to define patronage rights. While a three percent milk payment retain continued, only one and a half percent was retained as redeemable, allocated member equity. The additional one and a half percent became permanent equity for the cooperative and constituted a risk capital investment on the part of the producer.

When the cooperative completes product marketing, productivity fund investment is considered to settle patronage claims. The fund functions as a financial backing mechanism for commodity deliveries. The philosophy is that if a producer delivers a certain proportion of commodity inputs, they should contribute an equal proportion of risk capital to the cooperative. If producer's capital contributions are lower than the proportion of milk delivered, the portion of milk deliveries not backed by capital contributions to the productivity fund is not eligible for a patronage refund. The producer would receive only the upfront, base milk price.

The sustainability of the productivity fund will be determined by the ability of the cooperative to achieve two objectives: 1) to assign an accurate value to productivity fund share prices and 2) to form and implement a strategic plan for the cooperative despite potential internal, political constraints. In order to

assign an appropriate value to the share prices, the cooperative had to attempt to determine the added value to members of buying into the productivity fund.

Those producers faced with the decision of whether to buy into the new cooperative structure are met with several incentives: 1) the assurance of receiving patronage refunds from the productivity fund which would directly increase the price of their milk payments and 2) a reduction in risk through a pooled refund.

If the setting of the productivity share value is successful, the productivity fund will be stable. Nevertheless, in revaluing the cooperative the temptation arises to sell shares to each member based on their original quota. However, Conaprole members believed part of the cooperative asset base should remain pooled in order to maintain the cooperative's original spirit. Facing a necessary restructuring of their organization, Conaprole grappled with the question of how cooperatives can reorganize their capital structure to respond to global market pressure while sustaining producer cooperation through a common equity pool.

This is a key consideration in positioning the cooperative structure to remain competitive in the future. If the organization would like to continue being cooperatively owned, what is the ideal ratio of risk capital contributions to common equity shares? What portion of the equity should be redeemable as opposed to non-redeemable and transferrable? Cooperatives are continually reconsidering an ideal equity structure.

Future Alignment of Control Rights to Capital Structure Reorganization

After reorganizing the internal capital structure, Conaprole must now decide whether to restructure decision and control rights. Should the current one-member, one-vote system be restructured to a new system based on productivity fund capital investments? If decision rights were to be proportionate to capital contributed, two alternatives are possible. The first alternative would be to retain a single governance pool. The second alternative would be to develop two governance pools: one pool proportionate to patronage and one pool proportional to capital contributions.

How should Conaprole proceed? It is sufficient to reorganize the capital structure of the organization without redistributing representation and control rights? What portion of their cooperative earnings should they maintain as common, redeemable equity shares?

Anselmo looked at his son and calmly reminded him, "Remember this: price and risk are two sides of the same coin. If someone offers you more, remember you are taking a risk. In this case, you are risking your capacity to make decisions among free men that act on their own accord. That is something I am not willing to risk. True liberty is being able to make decisions for your future although it may require a sacrifice today."