The internationalisation of agricultural co-operatives: critical factors in development

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Abstract

Internationalisation of agricultural co-operatives is a worldwide trend and has been identified by several studies as one of the key challenges co-operatives are currently facing.

This paper provides a comprehensive literature review of the internationalisation of agricultural co-operatives globally, including the identification of the critical factors in their development.

Starting with a review of the traditional definition of co-operatives and their unique characteristics, the paper explores the emergence of new co-operative models, reasons for internationalisation as well as the barriers to it, forms of internationalisation adopted by co-operatives, and potential conflicts that can arise. The paper goes on with a new descriptive model for determining internationalisation of co-operatives.

Finally, using the mentioned model, the paper includes case studies of two New Zealand co-operatives: Fonterra, a pure co-operative in the dairy industry and Zespri, a co-operative hybrid in the kiwifruit industry, and their internationalisation situation.

Keywords: agricultural co-operatives, internationalisation, international business, agribusiness, dairy industry, kiwifruit, Fonterra, Zespri.

Agricultural co-operatives

1.1 Background: definition, principles, characteristics and types

Principles play a central role in co-operatives and they define to a great extent the nature and role of co-operatives. Disagreement exists about what constitute the 'true co-operative principles', as they have evolved over time and co-operatives with them (Barton, 1989; ICA 1995).

Despite the differences, some general definitions can be found. For example: 'a *co-operative is a user-owned and user-controlled business that distributes benefits on the basis of use*' (Barton, 1989, p.1). A very similar and generally accepted definition (and the one that will be used for this study) states that a co-operative is an agricultural producer organisation that is user-owned, user-controlled and user-benefited (Cook, 1997; USDA, 1997).

When analysing the reasons behind the formation of co-operatives one can also find differences, but in general terms co-operatives are formed with the objective of providing services to agricultural producers (the members), which they as individuals, cannot provide by themselves or at least not so effectively (McBride, 1986). As a general rule, '*co-operatives are considered means of correcting or mitigating market failures*' (Harte, 1997, p. 43). Although the primary purposes of co-operatives are economic-related benefits for its members, co-operatives may pursue some non-economic objectives as well.

Although the co-operative movement is extremely important all through the world with total sales of agricultural co-operatives estimated at US$ 450 billions (Centre de Gestion des Coopératives, 1995), they play an extremely important role in the developed world, especially in countries like the US, Canada, and the Netherlands among others (ICA, 1995).

In several aspects co-operatives are similar to other forms of businesses such as Investor Oriented Firms (IOF), they operate in the same business environment and under the same rules, electing a board of directors and hiring managers. Most importantly they share the same common objective of maximising long terms wealth of shareholders/members (Lynch, 1998). On the other hand co-operatives are unique in several aspects when compared to other forms of businesses.

There are three key differences that distinguish a co-operative from other forms of business. These are the user-owner principle, which means that the persons that own and finance the co-operative are those that use it; the user-control principle, which implies that the control of the co-operative is under those who use it either on a proportional or democratic basis; and the user-benefit principle, which implies that the benefits of the co-operative are distributed to its users on the basis of their use (Barton 1989, McBride 1986, Nilsson 1996). A critical difference is that while IOFs have the single objective of maximising value at firm level, co-operatives must maximise value both at co-operative/firm level and at member level (Lynch, 1998).

Another of the unique characteristics of the co-operative form, which is often overlooked, is the way relationships between the co-operative members, board of directors, and the managers, also called the 'management triangle' are handled. The involvement of the members in management decisions is a critical difference with other forms of businesses (McBride, 1986). While such differences make co-operatives a distinct form of business organisation, just as in any business, in order to compete successfully, they must be soundly financed, managed and run (Schroder, Wallace & Mavondo, 1993).

Co-operatives can be classified according to size (large, small), financial structure (stock and non-stock), organisational structure (centralised, federated, mixed), geographic area served (local, regional, national, transnational), function performed (marketing, supply, processing, bargaining and service), scope (vegetables, dairy, meat, etc) and the already mentioned classification according to the principles ruling them, among others classification systems. Therefore, several taxonomies of co-operatives have been elaborated (Cook, 1995; Van Dijk, 1996).

An extremely important group, and the ones covered in this study, are marketing co-operatives. Marketing co-operatives link members' production, product processing and food marketing at local, regional or international level, with the first two options being historically the chosen ones (Bager, 1997). Traditionally, marketing co-operatives have concentrated in selling their members' farm product either in raw or processed form, but lately marketing co-operatives are becoming more vertically integrated, increasing control all the way up to the retail level, even on an international level (Cobia, 1989).

1.2 Changes in the international scene and emergence of new co-operative models

Changes in the international scenario have been one of the major forces behind the restructuring of agricultural co-operatives worldwide. Among them competition has increased, consumers have become more demanding, technological changes in logistics and storage have been drastic, retailers have become more powerful and concentrated, and globalisation of economies has resulted in economies of scale in production, logistics and marketing (Verheijen & Heijbroek, 1994; Bijman, Hendrikse & Veerman, 2000).

As a consequence of deregulation and globalisation, competitiveness is increasing, impacting on co-operatives as it is on other types of business. But while some of the weaknesses of the traditional co-operative model are being exposed, on the other hand, co-operatives' major competitors, multinational food corporations are actively expanding their activities, making the food industry more concentrated (Schroder et al., 1993; O'Connor & Thompson, 2001; Wilson 1999). At the same time, governments are reducing their financial support, undermining some of the benefits of being in a co-operative (Harte, 1997; Wilson, 1999).

With the drastic explosion in international trade that the world has seen over the past 40 years, co-operatives have also become increasingly involved in exporting, agricultural markets have become global rather that local, with the opportunities, challenges and risks this implies. Risks are magnified in the export market by multiple factors such as currency exchange, transportation, trade and non-trade barriers, etc (Bijman et al., 2000).

It should be noted that differences among co-operatives in different continents and countries are considerable (Centre de Gestion des Cooperatives, 1995). The same happens among sectors such as dairy where co-operatives have an extremely high market share, compared with others where they have little or no power (Bager, 1997).

However, despite the previous point we find that "*Integration in the milk sector, amalgamation of farmer owned meat businesses, joint ventures with co-operatives or in the private sector across national boundaries is commonplace through the food chain*" (Wilson, 1999). The issues facing co-operatives are universal, the choices and need for change are different only because of local laws, regulations, and local market anomalies (Cook, 1996).

Several authors such as Nilsson (1998), Wilson (1999) and O'Connor & Thompson (2001) have performed international descriptions of worldwide trends of agricultural co-operatives, focusing especially on structural changes; 'c*o-operatives around the world find themselves in a period of major, perhaps unprecedented changes'* (O'Connor & Thompson, 2001, p.1).

The world trend of mergers of co-operatives has been especially strong in some sectors, such as the dairy industry. Despite this shift to fewer and larger co-operatives Wilson (1999) found a counter swing by the formation of new groups such as machinery rings or farmer markets more recently. In general, the nature, structure and professionalism of co-operatives have been changing, with emphasis being placed on co-operation rather than the legal form of the business (Nilsson, 1998; Wilson, 1999).

As a consequence of the agricultural co-operatives intent of remaining competitive within the increasingly internationalised, deregulated and demanding markets previously described, and in order to overcome a numbers of limitations inherent to the traditional form of co-operative, several new co-operative models have been emerging over the last years (Cook, 1995; Nilsson, 1996; Stranskov, 1996), '*The structures and strategies of co-operatives … are all being questioned* - or should be - *as local and national food systems become integrated into a new, global food system*' (Cook, 1996, p. 143, emphasis added).

The main inherent limitations that these new models have been trying to overcome have been well studied and can be summarised as the common property problem, the portfolio problem, the horizon problem, the decision-making problem, and the control problem (Nilsson, 1996). Harte (1997) condensed them as the horizon problem, the portfolio problem, and the control problem. Using other words but following the same logic Cook (1995) identified the main co-operative limitations to ownership issues, control issues, and dilution of benefits issues.

According to Nilsson (1998) a new agricultural co-operative model is emerging with the primary processing being conduced within increasingly larger co-operatives with some operating even internationally, and with the trade between the co-operative and its members becoming more business-like. According to Nilsson, the traditional co-operative model with its many ideological attributes has a precarious future. In Nilsson's model the collection and first stages of processing remaining in the co-operative, with the subsequent processing being conducted by partly owned subsidiaries. This model fits with the current reality of Irish and U.K co-operatives.

In the United States, during the 1990's a group of new co-operative business structures, focused on value-added processing (as opposed to the traditional commodity marketing) have been formed, receiving the name of New Generation Co-operatives (NGC). NGCs have been studied in depth over the past years (Cook, 1995 and 1996; Nilsson, 1998), with local adaptations of the NGC model being implemented in Australia (Plunkett & Kingwell, 2001), New Zealand (Frampton, 2002), and Canada (Ketilson, 1997) among other developed countries.

NGCs have been seen as a possible solution to overcome the traditional co-operative limitations without weakening the essential co-operative principles (Cook, 1995 & 1996). NGCs are typically (with exceptions) small, high-focused co-operatives. The core characteristic and main difference of the NGC is that capital is not treated as common property; instead members hold a number of shares proportional to their delivery rights, which in turn operate as a two way-contract between the co-operative and the member for a certain amount of product. Other interesting characteristics of NGC are: the use of equity tradable shares among shareholders/farmers, closed memberships, and the requirement of full contribution to equity capital when joining (O'Connor & Thompson, 2001).

Finally, Stranskov (1996) identified four co-operative models that were taking form. The first model consists of large farmer-controlled co-operatives, with outside institutional investors; the second model assumes internationalisation of the co-operative; in the third model co-operatives would concentrate in their traditional activities, leaving marketing to an outside strategic partner. Finally in the fourth model, co-operatives form strategic alliances with cross-border IOFs or co-operatives. Grosskopf (1996) described two models of European co-operatives taking shape: first, a truly international co-operative with members having ownership and membership rights across national boundaries; the second model, is an interregional entity, owned by regional co-operative members.

1.3 Future opportunities and challenges

> "Co-operatives are at a crossroads in their development. The future of co-operatives depends on the ability of their leaders to convince members to structure themselves in order to compete on multi-commodity, value added and global bases" (Lang, 1995, p. 4).

A mix of positivism and negativism can be perceived when reviewing the specialised literature, in relation to the future of co-operatives. Some authors like Bager (1997) are extremely optimist about co-operatives' future. Cracknell (1996) on the other hand, although recognises that no intrinsic reason stops co-operatives being efficient and competitive, provided they have dynamic and imaginative management, warns that the movement must be rebuilt from the grass roots. Wilson (1999) agrees with the view, stating that drastic changes are necessary.

The existence of multiple possible partners, products, markets, and services options have located co-operatives at a point where significant new choices are again essential (Lang, 1995). Greater responsibility lies now over the co-operative's board of directors, in order to seize opportunities and understand that co-operative philosophy and principles are not inconsistent with the requirements of the dynamic competitive environment (Wilson, 1999; Verheijen & Heijbroek, 1994), "*Historically, co-operation has flourished in times of adversity*" (Wilson, 1999, p.100).

Consensus exists in the specialised literature, that co-operatives have to move closer to the consumer and reach further up the value chain where more profits can be found (Lang, 1995; Strandskov, 1997). Traditionally co-operatives have focused in obtaining economies of scale to reduce input prices or by collaboration to improve marketing effectiveness. Although these functions are still relevant, there are new rationales; the objective in business co-operation must be to make the value chain more efficient and profitable, by pooling assets, time and knowledge (Wilson, 1999).

An important issue is however, how close to the final consumer should (and realistically can) co-operatives get, because even though the potential rewards are attractive, co-operatives that decide to vertically integrate and market final consumer products are faced with challenges such as the developing of a customer-oriented organisation, the establishing of a recognised brand, constant development of new products, and others which may be difficult and expensive to achieve (Cobia, 1989).

In terms of product differentiation, it is increasingly likely that both domestic and international markets will call for differentiated consumer products rather than commodities. The more promising opportunities of the future for co-operatives may lie in development of new, customised products, which will increasingly be produced, processed, and marketed outside of traditional channels (Seipel & Heffernan, 1997).

Also, with the expansion of regional pacts (NAFTA, EU, Mercosur), co-operative members are beginning to understand the value of welcoming foreign producers of complementary products under the co-operative umbrella. Co-operatives will continue to expand beyond exporting into other offshore activities, which in turn will enhance the presence and visibility of co-operatives in markets around the world (USDA, 1997). Book

(1992) argues that internationalisation should be present in all planning and strategy development by co-operatives. According to him the distribution of activities should increasingly be considered in the international context.

Internationalisation of agricultural co-operatives

2.1 The choice of internationalisation

The Federation of Danish co-operatives (2000) defined ‘international co-operative’ as any co-operative that has initiated one or more of the following forms of internationalisation: Export, Alliances, FDI and/or organization of transnational co-operatives. According to this definition several agricultural co-operatives in Europe, North America, Australia, and New Zealand have been international for a long time as they export a significant proportion of their production.

Whether to internationalise or not, should be one extremely important decision among several strategic decisions that agricultural co-operatives are currently evaluating in order to respond to the previously described pressures. Other strategic options may include: concentration paths (union, merger, acquisition, partnership, joint venture), diversification versus specialization, vertical versus horizontal integration, and cost leadership versus product differentiation (Mauget & Declerck, 1996).

Despite of the work of several researchers and co-operatives’ leaders supporting internationalisation (Book, 1992; Salaberria, 1997), only a limited number of agricultural co-operatives have expanded production into foreign markets, although the number is growing (Bager, 1997). Mauget & Declerck (1996) found, when comparing structures, strategies and performance of agricultural co-operatives in the EC, that expansion into international markets remained weak at that time.

Buccola et al (2001) found that the most important factors that determine co-operatives choice of internationalisation form are the capital subscription methods, marketing objectives, foreign experience and propensity, and the nature of the products manufactured. Co-operatives have to decide now how they can internationalise sales and production, taking in consideration the special preconditions of individual geographical (Federation of Danish Co-operatives, 2000).

2.2 Reasons for internationalisation of agricultural co-operatives

The reasons behind the internationalisation of agricultural co-operatives are in general terms exactly the same as that of any form of business, such as continued growth, utilisation of economies of scale, strengthening of competitiveness, utilisation of know-how, access to export markets, direct presence in important markets, and ability to seek resources abroad (Federation of Danish Cooperatives, 2001). Buccola et al. (2001) shortened the list, considering that there are only three main possible reasons why co-operatives internationalise: increasing the firm’s market share, enhancing average sale price, and reducing or diversifying risk.

Competitive pressures have arisen, primarily from multinational companies, which are making national boundaries increasingly irrelevant through the use of new technologies, combined with highly mobile investment capital, and global sourcing of raw materials and labour (Seipel & Heffernan, 1997). On the other hand, as it has already been stated, the particular goals and conditions of co-operatives mean that the motivations and starting points for internationalisation differ in certain areas from the IOFs ones (Federation of Danish Co-operatives, 2000). So for example, global sourcing can be a strong competitive reason for co-operatives to internationalise, but at the same time it can be a limiting factor (USDA, 1997).

The motivations and mechanisms for foreign sourcing strategies are various. So for example, sourcing of non-members raw products, which may seem contradictory at a first glance, can be related to lowering per-unit costs through greater use of plant capacity, or the fill of seasonal marketing windows for maintaining all year round availability, or for broadening the co-operatives product line (USDA, 1997). Finally co-operatives may expand their memberships to include foreign members; so foreign sourcing can be a previous step to the formation of transnational co-operatives (Federation of Danish Co-operatives, 2000).

The issue of economies of scale and reaching sufficient size is also one of the big forces behind agricultural co-operatives internationalisation. “*Sufficient size is essential for all strategic options… internationalisation or regionalisation is often a possibility and sometimes a necessity*” (Verheijen & Heijbroek, 1994, p. 174). An important point is that not only large food companies in general and co-operatives in particular, can become international. Size is not a necessity for internationalising (Bager, 1997), although it is sometimes a consequence.

There are inherent advantages in the co-operative form, which make co-operatives specially suited for internationalising that cannot be underestimated when considering international expansion (Cook, 1997; Salaberria, 1997; Federation of Danish Co-operatives, 2000). Grosskopf (1996) and Seipel & Heffernan

(1997) see in the co-operative's organisational and ownership structure important strengths for internationalisation.

2.3 Problems and barriers of co-operatives internationalisation

Although the reasons behind internationalisation are the same for IOFs and co-operatives, the barriers and limitations to internationalisation for co-operatives are not exactly the same (Book, 1992; Schroder et al., 1993; Nilsson 1996).

Co-operatives' traditional preconditions towards considerable capital requirements, willingness to take risks, long-term patience and fast decision-making, put them in a different and disadvantaged situation for taking part in processes like internationalisation in comparison with other forms of business, specially against IOFs. Multinationals (a type of IOFs) experience in setting up business and carrying on production abroad, together with their ability to raise capital from the share market, ensures them rapid expansion (Federation of Danish Co-operatives, 2000).

According to Schroder et al. (1993) there are six barriers which agricultural co-operatives and in general, Producer Marketing Organisations (PMO), have to overcome in order to internationalise.

These barriers are:

1) developing of a marketing orientation instead of producer orientation,
2) the location in the food chain, as they are at the beginning of the chain far from consumers and market signals,
3) the sourcing of raw materials dilemma,
4) relationships with governments (when government support exists),
5) strategic thinking barriers, and
6) the development of a long term financing strategy.

From the six mentioned barriers, Schroder et al. (1993) stated that the first four, apply to all PMOs irrespectively of their size and stage of maturity, with the last two being important in the early stages of their lives.

Seipel & Heffernan (1997) identified as limitations to co-operative international involvement: the diverse interests of members, the aversion to higher risks associated with international investments, the horizon problem (aversion to long-term commitments with little short-term benefits), and the physical ties to domestic resource bases. In terms of international involvement with foreign co-operatives, they identified the problem of different connotations (some of them bad) of the co-operative concept in some countries. Co-operatives' risk aversion was also identified by Grosskopf (1996) and Buccola et al. (2001) as one of the biggest barriers for internationalisation.

An important limitation to co-operatives internationalisation lies in the fact that most co-operatives have ties to producers/members within a particular region, and they do not have the same freedom in shifting production and processing around the world that IOFs have (Seipel & Heffernan, 1997, Federation of Danish Cooperatives, 2000).

Cook (1997) states that co-operatives face the following constraints when internationalising: mission clarity, single origin nature, capital availability, and governance (lack of skilled outside directors). Even though most of the barriers identified by the mentioned researchers are similar, no total agreement exists, even though it could be said that some consensus exists identifying the 'financial' or 'capital problem' as a key one.

O'Connor & Thompson (2001) argued that financial limitations are not only a big internationalisation barrier, but they are the origin (entirely or partially) of a big part of the co-operative traditional weaknesses. According to Salaberria (1997), president of the Confederation of Co-operatives of the Basque country (Spain), the solution to the financial problem lies in a change of co-operatives' attitudes to capital, by thinking of realistic and economically stimulating means of capital contributions, either from their own members or from outside members.

The existence of considerable barriers does not imply at all that co-operatives cannot successfully internationalise. Schroder et al (1993) stated that co-operatives and producer marketing organisations can in fact overcome the internationalisation barriers and cited the New Zealand Dairy Board (NZDB), as a successful case.

According to Huet (1996) a market-oriented focus (as opposed to production-oriented) and a shift from defensive to offensive strategies (Egerstrom, 1997) are mandatory if co-operatives are going to compete in international markets. Finally Seipel & Heffernan (1997) see in the constant creation of local and regional niches in the food system, the logical response to globalisation pressures from co-operatives.

2.4 Internationalisation forms

The internationalisation terminology differs between the business literature and the co-operative specialised literature. So for example while in the business literature (Bartlett & Ghoshal, 2000; Hill 2001) the term 'transnational' is used to describe an organisation with its physical assets (subsidiaries) dispersed internationally, but interdependent as the most evolved form of international organisations. On the other hand, the co-operative literature defines a transnational co-operative as a co-operative with members in two or more countries (Federation of Danish Co-operatives, 2000), although it is also possible to find the term 'international co-operative' being used for the same meaning (Verheijen & Heijbroek, 1994).

Internationalisation of co-operatives is a world trend, with American co-operatives using foreign direct investments (FDI) forms, and Europeans co-operatives moving towards the transnational co-operative form (O'Connor & Thompson, 2001). Bager (1997) stated that three general models are adopted by co-operatives with strong international commitment: the conversion to limited company; the formation of limited subsidiary, and issue of shares to members/farmers and non-farmers. Even though this classification may fit the Irish scene – where Bager did the research – it is somehow limited for applying worldwide, but still useful for comparison purposes.

Co-operatives as well as IOFs, when internationalising use a portfolio of arrangements including trading companies, foreign distributors, brokers, licensing, and foreign direct investments, according to the product and market conditions. On the other hand, the factors influencing the election are considerably different from the IOFs ones, being strongly based on factors such as financial resources and structure, risk exposure and risk preferences, information resources and product types (USDA 1997, Buccola *et al*. 2001).

Overseas business arrangements can be ordered according to the degree of commitment the firm/co-operative makes in the international venture. Using this scheme, Buccola et al. (2001) ordered, from least to greatest commitment, overseas business arrangements used by co-operatives as: 1) domestic sales to an overseas trading company, 2) sales through a foreign distributor, 3) sales through a foreign broker, 4) direct sales to an overseas wholesaler or retailer, 5) overseas coventure (licensing), and 6) foreign direct investment.

Cook (1997) condensed into four basic options the forms of internationalisation for agricultural and food firms: importing, exporting, FDI, and commercial relationships – including JV, coventure, franchising, licensing, and strategic alliances. However, more detailed business internationalisation studies have identified as many as nine different stages of internationalisation (Bartlett & O'Connell, 1998).

2.5 Potential conflicts

The arisen of potential conflicts when internationalising have been identified by several researchers (In't Veld, 1996; Normark, 1996; Van Dijk, 1996; Salaberria, 1997). Internal conflicts may come from several sources, like members seeing their co-operatives undergoing rapid changes, and not understanding or appreciating these changes. Conflicts may be short or long-term conflicts. Van Dijk (1996) advises as a possible solution to avoid conflicts, that managers and farmers-directors bring in consultants to help formulate and evaluate business strategy.

Normark (1996) states that proposal of strategic changes are often evaluated from the viewpoint of effectiveness within the co-operative, without paying much attention to the member-perspective. Change's proposals that are successfully created in a way that balances both the user's interests with the business logic are important for the long run of the co-operative.

In't Veld (1996) stated that values should not be isolated from a co-operative business as they are the foundations of the co-operative form. So when co-operatives are growing in size and scope, theses values need to be re-examined, '*Member orientation – the true touchstone of the co-operative identity – has tended to become increasingly mixed with profit orientation'* (Bager, 1997, p. 12). The question may be, is that wrong? According to the USDA (1997) "*Co-operatives must balance the interests of members with the need to compete in a dynamic and competitive marketplace through globally focused strategies, which is in turn essential to the interest of members*".

Kyriakopoulos (2000) argues that many aspects of the market orientation restructuring of co-operatives, which has become necessary in order to compete in the current business environment remain dark, especially those associated with the integration of co-operative firms and members. Van Dijk (1996, p. 176) points in the same direction, "*Strategic policies such as scaling up, internationalisation, or vertical integration, must be judged against the aims of the co-operatives members…. That sounds simple, but it is hardly the case"*.

2.6 Case study research on internationalisation of agricultural co-operatives

Dobson (1992) analysed the New Zealand Dairy Board (NZDB) strategy and its manifested intention of becoming a multinational food company. Another case study where the NZDB was the main focus of attention is the study performed by Schroder et al. (1993), where they cite examples of globalisation strategies used by Producer Marketing Organizations (PMO), discuss the barriers that must be overcome, and with a case study, show how a PMO, the New Zealand Dairy Board (NZDB), can successfully overcome those barriers.

Mauget & Declerck (1996) studied EC agricultural co-operatives' behaviour and performance on the period 1990-1991. Related to internationalisation they described the remarkable expansion into foreign markets of Danish meat processor co-operatives and the acquisition of foreign companies to process products followed by Danish dairy cooperative MD Foods in the Middle East, and Irish dairy co-operatives in the U.K. and the U.S. (Avonmore, Waterford, Golden Ave, and Kerry). Especially interesting is the successful case of Dutch dairy co-operative Campina-Melkunie, in raising funds by issuing members participation certificates. As a failure case of internationalisation the experience of a French dairy Coop, ULN, was analysed.

The Basque Mondragon Co-operative Corporation (MCC) has been the centre of several studies that have tried to understand the reasons behind its successful growth without loosing its co-operative status, although some questioning regarding its loyalty to co-operative principles have also arisen (Hanna, Ridnour, & Meadow, 1992; Huet, 2001; Kohler, 2002). Internationalisation is the main growth strategy of the MCC with establishment of foreign subsidiaries, acquisitions, JV, and international alliances, consolidating a US$ 5 billions business.

Seipel & Heffernan (1997) studied three American co-operatives, Land O'Lakes, Harvest States Cooperative, and Farmland Industries, which according to them have responded to the globalisation challenge. Land O'Lakes international activities include feed manufacturing, technical assistance and training activities; Harvest States participates with a transnational grain corporation and is also a member of a consortium of U.S., Dutch, Swedish, French and German co-operatives; Farmland Industries purchased a transnational Swiss-based grain-trading firm, with offices in Switzerland, Germany, Argentina, France, and the U.S.

Ketilson (1997) in a study of the Canadian co-operative Saskatchewan Wheat Pool, which converted itself to a publicly-traded co-operative, reviews the democratic structures and process such as volunteer activities, survey of members, member education, and participation of members in decision making, which are considered necessary in order to remain true to its roots.

The Federation of Danish Co-operatives (2000), reviewed several European agricultural co-operatives in the process of internationalisation, focusing in the Transnational Co-operative form. The study covers eight case studies (Table 1), analysing barriers and obstacles, legislation issues, success factors and alternative organizational models for transnational co-operatives establishment.

Worthy of being highlighted is the case of Dutch co-operative Aalsmer, the world largest auction hall for cut flowers and plants, which has 'full members' in Holland (96%), Germany (1%) and Belgium (3%), and 'special suppliers' in Israel, Kenya and Ecuador, besides receiving deliveries of 'normal suppliers' from large parts of the world. Also interesting because of its truly transnational structure is the case of Arla Foods.

Table 1: European examples of Transnational co-operatives (turnover data from 1998)

	Activity	Turnover	Members: number and composition
Milchunion Hocheifel	Dairy	573 mill DM	3,050 members (79% Germany, 13% Belgium, 8% Luxemburg)
COVAS	Sugar	80 mill NLG	3,000 members (97% Holland, 2% Germany, 1% Belgium)
Aalsmeer	Flower auction	2,959 mill NLG	3,500 members (96% Holland, 3% Belgium, 1% Germany)
AVEBE	Potato starch	1,603 mill NLG	5,600 members (68% Holland, 32% Germany)
Arla Foods	Dairy	36,000 mill DKK	17,600 members (54% Denmark, 46% Sweden)

Source: Federation of Danish Co-operatives (2000)

Model Development and Case Studies

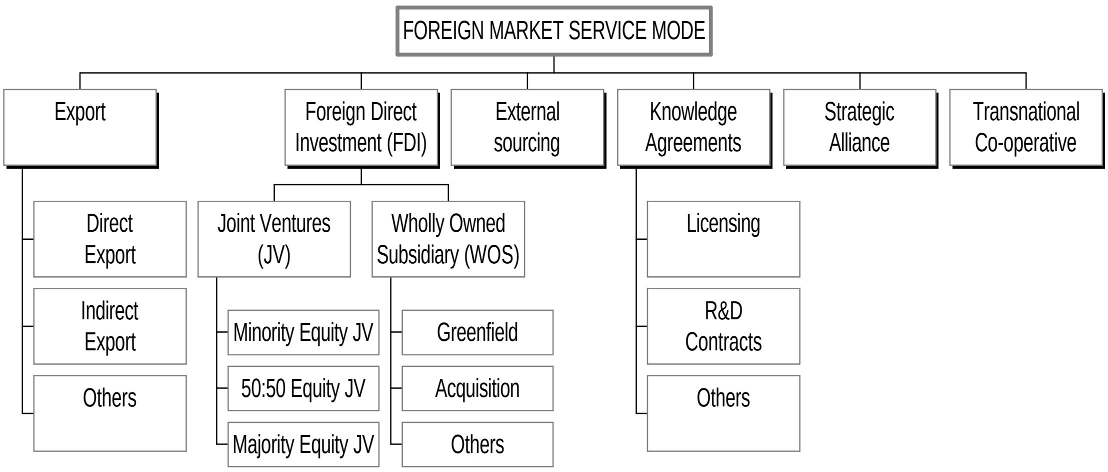
The development of a model of Foreign Market Service Modes (FMSM) used by agricultural co-operatives in the process of internationalisation

While analysing the case studies that follow, it was found necessary to organize all the different Foreign Market Service Modes1 (FMSM) used by the two studied agricultural co-operatives within a model.

The Federation of Danish Co-operatives (2000) defined 'international co-operative' as any co-operative that have initiated one or more of the following forms: export, alliances, direct investment and/or organisation of a transnational co-operative. The model, although useful, proved to be basic and limited for categorising certain FMSM. Pan & Tse (2000) developed a hierarchical model of entry market modes, which although very comprehensive and useful for differentiating FDI, JVs and wholly owned subsidiaries, is mainly focused to IOFs and therefore has limited application for agricultural co-operatives.

It is important to state that because of the exploratory nature of this case study (Yin, 1994) and because of the limited amount of existing research in the topic of internationalisation of co-operatives, the case studies description started using the mentioned existing models within the framework provided by the literature review, but as they proved their lack of fit, a new model was conceptualised (Figure 1). In this new model six main FMSM can be identified: exports, FDI, external sourcing, knowledge agreements, strategic alliances and formation of transnational co-operatives. Some of the main FMSM can in turn be subdivided into sub-modes like for example FDI into JVs and wholly owned subsidiary.

Figure 1: Model of Foreign Markets Service Modes used by agricultural co-operatives (Donoso, 2002)



Exporting, either directly or through intermediaries, is the most common way co-operatives enter international markets. For example, in 1995 over 90 US farmer co-operatives exported agricultural products individually valued at more than US$ 5.6 billion with around 70% of this consisting of commodities. In total co-operatives' exports accounted for about 12.3% of total US agricultural exports (USDA, 1997)

Foreign Direct Investment (FDI), which includes the establishment of subsidiaries and Joint-ventures (JV), is one of the most important forms of internationalisation used by co-operatives and by corporations in general, when internationalising.

External sourcing (also known as third party sourcing) is increasingly being used by co-operatives either to source non-competing products or complementary products, or to fill seasonal marketing windows. This last issue is especially critical in products where consumers expect year round availability, which is increasingly the case for all food products. Also foreign sourcing can broaden a co-operatives product line (USDA, 1997).

Knowledge agreements range from the simple sale of technology to licensing and franchising agreements, and it may represent the only alternative when trade and overseas investment are restricted/banned. Knowledge agreements involve minimal capital expenditure, if compared with the other servicing modes and they also represent a diversified source of income especially if technologies or managerial skills are under-

1 Although the specialised literature tends to use the term foreign market entry mode, the term Foreign Market Service Mode (FMSM) was used, as this is considered to be more comprehensive.

utilised. On the other hand, knowledge agreements also imply risks, especially those associated with the lack of control that the licensor has over the licensee (Enderwick & Akoorie, 1996)

Co-operatives can form international alliances either with foreign co-operatives or IOFs. The alliance may be constructed either as an agreement to co-operate within specific areas (marketing, production, R&D) or it may be constructed as a mutually owned enterprise covering all operations within one specific sector. Finally, alliances with overseas co-operatives may be used as a previous step for the formation of transnational co-operatives (Normark, 1996). Although alliances are complex organizational processes, co-operatives are starting to find what IOFs have known for a while; '*Increasingly, global companies are forming strategic alliances… Globalisation mandates alliances, makes them absolutely essential to strategy'* (Omahe 1990, p. 482).

The transnational co-operative is maybe the most 'extreme' of all the forms of co-operative internationalisation and although it can be correctly argued that it cannot be considered as a FMSM because at the moment of establishing a transnational co-operative the foreign market becomes local, the formation of a transnational co-operative can be considered as the last step in the internationalisation of an agricultural co-operative. However, the concept of transnational co-operation inevitably raises the question of member unity over country borders, different languages and different cultures (Normark, 1996).

The Federation of Danish Co-operatives (2000) defined a transnational co-operative as a co-operative that has: members in two or more countries, where members are equal as regards to rights and obligations, and where members have a common commercial goal applicable. Transnational co-operatives are the results of either national co-operatives admitting members from foreign countries or mergers between co-operatives in different countries, although intermediate forms also exist, such as co-operatives with gradually affiliated foreign members or foreign supplier without influence and obligations. Joint co-operative ventures, or cross-border mergers between co-operatives constitute other feasible alternatives before the formation of transitional co-operatives (Verheijen & Heijbroek, 1994).

Fonterra Co-operative Group case study

4.1 Company overview

Fonterra Co-operative Group (Fonterra) is a truly global company co-operatively owned by the 13,000 New Zealand farmers-shareholders who supply it. Fonterra has 20,000 employees, over 90 subsidiary and associated companies worldwide, annual revenues of NZ$13.9 billion and assets of NZ$ 12 billion, generating over 20 percent of New Zealand's export receipts and seven per cent of its Gross Domestic Product, making it New Zealand largest company.

In global terms Fonterra is the world's largest exporter of dairy products, and the fourth largest dairy company in the world (Rabobank, 2002) responsible for about a third of international dairy trade. It operates, through its two main subsidiaries, NZMP (dairy ingredients) and New Zealand Milk (consumer products) in 140 countries.

Fonterra is the result of the merger of the New Zealand Dairy Group, Kiwi Co-operative Dairies and the New Zealand Dairy Board (NZDB) in October 2001, which saw the simultaneous removal of the NZDB's statutory exporting monopoly and therefore the deregulation of the NZ dairy industry. Since its formation Fonterra has continued an aggressive programme of acquisitions, joint ventures and alliances worldwide.

The past season, starting with the supportive shareholders vote for Fonterra on June 2001, the finalisation of the merger on October 2001 and the presentation of its first annual report in July 2002, has been of record achievements for Fonterra and its farmers-shareholders including record revenues of NZ$13.9 billion, record processing of New Zealand milk of 1.1 billion kilograms of milksolids (kg ms), and a record payout to farmers-shareholders of $5.30 per kg ms. On the other hand, as the Shareholders' Council summarised it in its Annual Report, although significant progress has been achieved, the performance of the company in a number of key areas has been disappointing.

4.2 Business internationalisation

Internationalisation, even in its most primitive forms (i.e. exporting), can easily be argued to be the only choice for most of agricultural co-operatives in New Zealand because of the very small domestic market and if Fonterra was located in the US for example, it is probable that its growth focus would be internal/national instead on the international markets, as it is the case for example with Dairy Farmers of America2, but

2 Dairy Farmers of America is the world biggest dairy co-operative but it is only a very small player in the international dairy markets.

because Fonterra is based in New Zealand and because of historical dairy production levels it had no choice but to undertake the internationalisation path.

With a yearly production of over 1 billion of kg ms in a country of just over 3.5 million habitants there is clearly no option but internationalisation and this has been the case since the beginnings of the dairy industry in New Zealand. In fact when the name Fonterra was chosen, there was an obvious focus in choosing a name that was linguistically and culturally acceptable internationally, a name that would not limit the company to a defined geographical position or country, not even to New Zealand. Fonterra is involved in four out of the six modes of internationalisation from simple exporting to the formation of alliances, according to the model used in this study (Figure 1).

To understand Fonterra's internationalisation it is important to understand its predecessor in terms of international marketing, the NZDB. Dobson (1992) described the internationalisation process adopted by the NZDB as a three-steps process as follows: the NZDB would initially work through an agent, then the NZDB would form a joint venture (JV) with the agent in order to expand sales and finally it would end acquiring the joint venture partner and establishing a subsidiary. Internationalisation, above the initial stages of simple exporting and use of traders, happened over a period of 30 years and it can be said that started with the objective of market diversification when the UK entered the European Union and the NZDB found itself with a huge production and no secure market anymore, therefore it can be argued that internationalisation was a production-driven response.

Fonterra finds itself now in front of new challenges, entering JVs of bigger scale than the NZDB ever did and entering into whole new foreign market service modes like the strategic alliance signed with Nestlé in the Americas.

4.3 Foreign Markets Service Modes (FMSM)

Export

Although Fonterra is a truly multinational company with wholly-owned subsidiaries and joint venture companies spread over the world, exporting is still Fonterra's foreign markets main service mode. The United States is Fonterra largest export market (over $500 million) with Japan being the second ($330 million). The company's top eight export markets are bordering the Pacific Ocean.

As declared by the company its exporting potential is greatest in markets which are net importers of dairy products such as South East Asia (especially Japan and Korea), the Middle East, North America and Latin America, Northern and Southern Africa, and China.

Foreign Direct Investment

Fonterra operates in 140 countries, having 35 manufacturing plants spread in different parts of the world (plus 29 in New Zealand). In addition to the already existing world-reaching network of companies that Fonterra inherited from the NZDB, the company has continued an aggressive programme of acquisitions and Joint Ventures (JV) with other dairy and food businesses. Major acquisitions and JVs have been completed in Europe, the Americas, Asia and Australia over the first twelve months of the company's existence (Table 2).

Table 2: Summary of overseas deals undertaken by Fonterra (season 2001-2002)

Country	Overseas business deals
US	50:50 JV with Dairy Farmers of America for commercial production of milk protein concentrate (MPC)
United Kingdom	JV with Arla Foods (Fonterra 25% and Arla 75%) Merger of existing operations and Anchor and Lurpak butter brands
Mexico	Acquisitions of La Mesa (cheese) and Eugenia (spreads) businesses Fonterra's New Zealand origin dairy sales in Mexico are expected to increase by more than $200 million annually
India	50:50 JV with Britannia Industries ($25 millions investment)
Australia	Formation of Australasian Food Holding Company Ltd (AFHL) through the merger of Fonterra's Australian and New Zealander consumer products businesses

Fonterra’s interests in Australia

Of extreme importance in this analysis are Fonterra’s interests in Australia both because of the strategic importance of Australia in terms of world dairy trade and because of the company’s public definition of its home market considering New Zealand and Australia. Australia’s strategic importance for Fonterra lies in the fact that Australia produces around 25% of the world’s traded dairy products. That percentage summed to the 36% of world traded dairy products produced by New Zealand (of which Fonterra controls 95%) imply that the potentials for Fonterra in Australia are significant. Also, the fact of having a home market of 18.5 million people instead of only 3.5 million3, creates the economies of scale in plants, processing and distribution, as well branding efficiencies across the Tasman Sea, which are easily rationalised due to the similarities of both markets.

In July 2002, Fonterra and Melbourne based Bonlac Foods announced the merger of their consumer food products operations in Australia and New Zealand bringing together the Mainland and Tip Top businesses in NZ, with the Bonland Dairies4 and Peters & Brownes businesses in Australia under the name of Australasian Food Holding Limited (AFHL). AFHL is the single largest operating company within Fonterra Group and the largest company in the Australasian consumer dairy business, having estimated annual sales of more than $2.3 billion. Fonterra’s other interests in Australia besides AFHL and Bonlac Foods include an 18% stake in Australia’s only listed dairy food company, National Foods.

External sourcing

Fonterra has 35 manufacturing plants outside of New Zealand, which receive and process milk externally sourced as well as dairy ingredients supplied from New Zealand in order to manufacture a diverse range of dairy products. *“If Fonterra wants to sell (offshore) yoghurt and semi-fresh high value products it needs to use non-New Zealand origin product. You can’t export water profitably so it makes sense for us to source these ingredients from other suppliers”* – Greg Gent, Deputy Chairman, Farmlink magazine, December 2001.

On August 2001, NZMP signed an export agreement with Dairy America5, a marketing company representing major US dairy co-operatives including DFA, Land O’Lakes and five smaller co-operatives, to export milk powder from the US on commission and by that way become the largest exporter of that category out of the US.

Knowledge agreements (Licensing)

Although the development of international knowledge agreements is not a FMSM frequently used by Fonterra, some examples of licensing of products developed by Fonterra can be found. DR10™, a probiotic bacteria (bacteria with beneficial health effects) identified and developed by the Fonterra Research Centre, is a good example of the previous point. DR10 was commercially launched by New Zealand Milk under the name of Fernleaf Defense™; the product was then licensed to Danisco, one of the world largest food ingredient companies, to sell the product in selected overseas markets.

Strategic Alliances

On March 2002 Fonterra Co-operative Group and Nestlé S.A. signed a 50:50 alliance named ‘Dairy Partners Americas’ (DPA) which will set up JVs in North, Central and South America to market chilled dairy products, liquid milk and ingredient milk powders. JV companies formed under the alliance umbrella will have access to the brands of both companies. The alliance was classified by Fonterra’s CEO, Craig Norgate, as *“New Zealand’s biggest ever offshore commercial deal”.*

DPA will initially have a staff of 10,000 and an estimated first year turnover of US$1.4 billions in a dairy market worth US$100 billion. Prior to the agreement, Nestlé was already Fonterra’s largest client and largest competitor and now it has become its largest partner. It has been announced that DPA will amalgamate part of the businesses that Nestlé has in The Americas with some of the businesses Fonterra has in The Americas. Fresh milk for DPA will be sourced from the Americas itself but it will also represent opportunities for New Zealand sourced product including $300 million for Fonterra’s New Zealand-origin dairy ingredients.

The logic behind DPA is the combination of both partners’ complementary capabilities, in other words the combination of Nestlé’s capabilities in branding and marketing (including brand management, market infrastructure, market knowledge and contacts with local governments and organisations, etc) with Fonterra’s manufacturing capabilities (including large scale collection, processing, manufacturing and product development).

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3 Australia’s population (15 million) added to New Zealand’s 3.5 million gives a total of 18.5 million.
4 Until the merger Bonland Dairies was a 50:50 JV owned by Fonterra and Bonlac Foods.
5 Dairy America controls 70% of the US sales of skim milk powder.

The possibility of becoming a Transnational Co-operative

Even though Fonterra's leaders have made a clear point in stating that the possibility of becoming a Transnational Co-operative is not in the immediate plans of the company and the debate has not been held, Fonterra's current involvement with other co-operatives overseas and international evidence of transnational co-operatives supports the theory that the possibility is not outside the realms of possibility.

Of extreme interest is Fonterra's relationship with the Australian co-operative Bonlac, when analysing the theoretical possibility of becoming an Australasian co-operative. Fonterra currently owns 25% of Bonlac Foods of which Bonlac Supply Co. owns 75%. If Fonterra eventually decides to accept overseas suppliers-shareholders there are key areas that need especial attention like a transparent payout price in order to avoid cross-subsidisation, as well as issues around the capital structure that are not the purpose of this study to analyse. Also and maybe of greater importance, before overcoming structural barriers the company will have to overcome cultural barriers6.

Zespri Group Limited case study

5.1 Company overview

Zespri Group Limited (Zespri) is the holding company of Zespri International, the world largest marketer of kiwifruit, with annual revenues of NZ$ 800 millions generated from the sale of over 65 millions trays of kiwifruit (2002 data); the group also includes Zespri Innovation and Aragorn Ltd. as subsidiaries. Zespri currently has a 25-30% year-round market share of the kiwifruit category; the percentage goes up to 60-70% when considering only the Southern hemisphere supply season. Zespri is the statutory single-exporter of all New Zealand kiwifruit to all world markets except for Australia.

Zespri is a grower-owned and grower-controlled organisation with a genuine co-operative voting system of votes tied to production levels and shares, set within an IOF/corporate structure. So unlike a traditional co-operative where growers must have shares to supply, in Zespri, New Zealand kiwifruit growers (about 2,500) can supply without shares, but in that case they do not receive the shares dividend. Therefore, for the purpose of this study, Zespri is considered as a co-operative hybrid.

The season 2001/2002 was extraordinary for Zespri, generating record revenues for the third consecutive season of NZ$800.4 million, a record net profit after tax of NZ$7.2 million and a dividend payment of seven cents per share, the first of its three years of history, for growers-shareholders. The company has made public its intention of becoming a billion dollar company in a relatively short period of time. Essential for this is the need to transform itself from a seasonal (7-8 months) marketer of New Zealand kiwifruit to a year-round marketer of kiwifruit in order to be able to supply customers on a continuous basis.

The year-round supply strategy has two parts: the first one is the marketing of Green kiwifruit produced in different parts of the world under the Zespri brand; the second part is the licensing and posterior marketing of the Zespri-owned Gold kiwifruit variety to selected producers around the world. The strategy though, is proving hard to implement due to difficulties in procuring sufficient volumes of quality offshore product and also because of the Gold variety licensing moving slower than predicted.

5.2 Business internationalisation

Based on the model being used for this study (Figure 1) we find that Zespri is involved in four out of the six FMSM: export, FDI, external sourcing and knowledge agreements. The first two have been the ones traditionally used by Zespri (and previously by the NZKMB) and only in recent years has Zespri slowly started to externally source product and to license its Gold kiwifruit variety.

Internationalisation as defined by this study has always been present in Zespri's business strategy and when the name 'Zespri' was chosen it was fundamental to select a name with no linguistic or geographical limitations. For Zespri, as a company with a 99% dependence on international sales, gaining and maintaining market access is critical. This was originally achieved by traders, further on by establishing representation offices and finally by establishing subsidiaries in selected markets7.

"The development of offshore enterprises is the cornerstone for growth. It will enable us to enhance our leadership of the kiwifruit category, strengthen retail and consumer relationships, extend our influence

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6 After the announcement of the formation of AFHL, Victoria dairy farmers president, Peter Owen, said, "*we would like the profits and money that circulate in the Australian dairy industry to stay here for the benefit of supplier*". Simultaneously, on the other side of the Tasman, NZ Dairy farmers chairman, Kevin Wooding, said, "*farmers here want to know they won't be propping up their Victorian counterparts*" (fencepost.com, 2 July 2002).

7 For a more detailed study of the NZKMB, Zespri's predecessor, see Enderwick & Akoorie (1996).

through leveraging the Zespri brands and system and maximise future returns to both Zespri and Kiwifruit International shareholders" -Tony Marks, CEO Zespri, Kiwiflier letter, September 2000.

As current legislation in the New Zealand kiwifruit industry prevents Zespri from 'risking growers money by investing offshore', a separate company, Kiwifruit Internationalisation has been set up in order to somehow overcome the legislation and isolate New Zealand growers from offshore risk by underwriting Zespri's offshore activities.

5.2.1 Foreign Market Service Modes (FMSM)

Export

Although exporting is by far Zespri's main foreign market service mode, most of the volume is handled through subsidiary offices and therefore qualifies as FDI (see FDI service mode below). Because of New Zealand's counter seasonal nature, which means that in general terms Zespri starts trading New Zealand Kiwifruit when the local Northern hemisphere kiwifruit season is over, Zespri has no problems in terms of market access in any country of the world where it trades fruit8.

As defined on its annual report 2001, Zespri exporting strategy is to target Europe as the high volume and strong value market, Japan and selected Asian countries as premium markets (kiwifruit prices in Japan are generally 50% above the average global price) and North America for absorbing the extra Green and Gold kiwifruit. By spreading markets the company is able buffer the impact of low prices in any determined market, even though the company is highly dependent on Japan and Europe, where over 80% of its export revenues are originated.

Foreign Direct Investment

Zespri International has a number of subsidiaries, but the world is essentially divided into two marketing arms, one of them is Zespri Europe with its headquarters in Belgium, which has subsidiaries under in France, Spain, Italy and the UK. The other marketing arm is the Asia Pacific, which is based in Japan and includes the Americas-Asia Pacific area and it also has subsidiary offices in Korea and Taiwan. Zespri also has a minority equity interest in a North American fruit trading company, David Oppenheimer & Company.

External sourcing

The 12-month supply business strategy based on the complementation of New Zealand grown kiwifruit with externally sourced fruit (mainly from Italy and the US, but also from California and potentially Chile) is proving hard to achieve for Zespri; first attempts of externally sourcing Green kiwifruit were done in 1999 and after three seasons, problems in ensuring quality and sufficient volumes have kept the strategy still on its infancy and even delivering red numbers (in 2001-2002 a $136,000 financial loss was underwritten by Kiwifruit International).

Knowledge agreements (licensing)

Zespri International manages the licensing, harvesting and distribution of Gold kiwifruit. The licensing contractual relationship indicates that Zespri owns the plant variety rights of Gold, the selected growers grow the fruit on behalf of the company, who finally takes the fruit and markets it under Zespri systems. By 2002 there were over 300 hectares of Gold kiwifruit being grown in Italy, 300 hectares in California as well as small areas in France and Japan, but as the company has admitted offshore licensing is moving slower than expected. Considering that the intention of the company is to complement New Zealand's Gold kiwifruit production (currently 2000 hectares), the current 600-700 hectares are at least a third of the ideal area.

The possibility of having overseas growers-shareholder and becoming a transnational co-operative hybrid

Although Zespri has repeatedly manifested its intention of remaining New Zealand growers-owned and controlled and it is not part of the current strategy to accept overseas growers-shareholders, the potential benefits that can be obtained from having international suppliers-shareholders and also, overseas growers manifested interest in getting into partnership arrangements with Zespri make the possibility worthy of analysis.

Zespri is currently working closely with Italian and North American growers. This close collaboration implies that technical assistance is being provided to overseas growers and also that overseas growers are being trained in New Zealand.

Is it possible that over time these contractual relationships will evolve to partnership agreements and accepting overseas growers-shareholders? Time will tell.

8 The only exception to that rule happened on the US in 1992 when the NZKMB was accused of dumping product in the US market and effectively banned from that market for eight years.

If Zespri eventually decides to introduce offshore growers as shareholders there are several structural, legal and cultural barriers it has to overcome, with probably the last one being the most difficult. At this specific point in time Zespri's short-term priorities on the international side are on making the 12-month supply strategy work.

Conclusions

Internationalisation has become a reality that agricultural co-operatives cannot and are not longer ignoring, although limited research exists on this topic. In this paper a new model of Foreign Market Service Modes (FMSM) for agricultural co-operatives in the process of internationalisation was developed. The new model, proved to be useful for organising the vast array of FMSM used by the two studied co-operatives and of others found in the literature. Also identified in the research was the need to determine agricultural co-operatives can successfully internationalise without generating conflicts with their members or distancing from them.

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