11. Losing sight of purpose – the United Farmers Co-operative Company

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INTRODUCTION

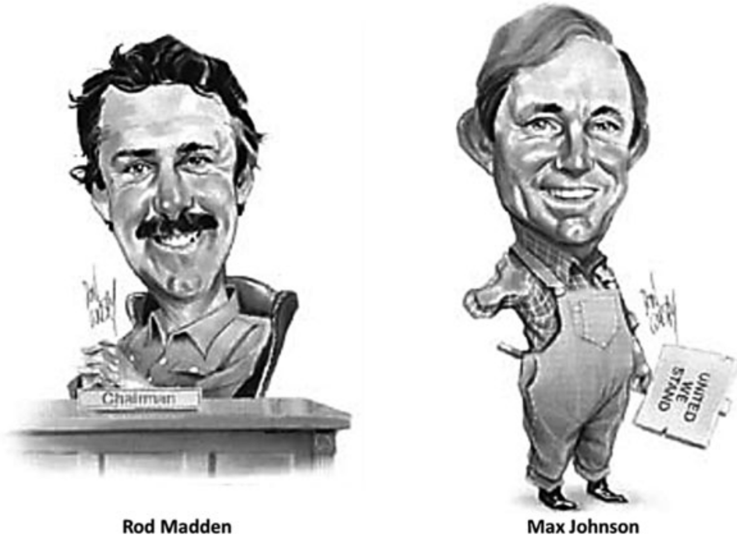
A few passionate and determined farmers got together in the early 1990s and created United Farmers Co-operative Company (UFCC) in an effort to fight off the oligopolistic fertiliser market in Western Australia. UFCC grew exponentially for a decade but faced a number of challenges leading to a sharp decline and eventually a merger into a larger, New Zealand fertiliser co-operative in 2008. Despite its short history, UFCC has 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.

This chapter will explore the reasons that led to the demise of UFCC. Was it the nature of the business model, was it the governance processes, or was it the competitive market environment? Our investigation will be based on evidence gathered through a series of interviews with past board members and managers, as well as data collected from secondary sources including annual reports, published histories and internal company documents. Our findings will be discussed against the literature on business models, the life cycle theory (Cook 1995) and the co-operative enterprise research framework introduced in Chapter 2, as well as literature on co-operative governance practices (Mazzarol, Simmons and Mamouni Limnios 2011). In conclusion, we aim to distil the findings from this case to offer lessons for other co-operatives, their members, boards and managers.

HISTORICAL OVERVIEW

1991–1994: A Spartan Operation

In 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, demanding a minimum price of wheat to be guaranteed (subsidised) by the government. In April 1991 the Rural Action Movement (RAM) was established to progress farmers' interests through political action. The president Max Johnson and deputy Rod Madden were both young, visionary individuals who quickly realised 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) and Sumitomo (trading as Summit Fertilisers) which at the time enjoyed high profit margins. Organising the financing for the first shipment was an administra-



Source: Warren (2002).

Figure 11.1 UFCC leaders Rod Madden and Max Johnson

tive ordeal; $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 finalised 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/tn on the market . . . we dropped the price by $115/tn. (Source: interview 2011)

UFCC was formed the following year to provide an incorporated body that would facilitate transactions with the banks. An early dispute in 1992 led to one of the founding directors and the first manager leaving and in 1993 John Read was appointed as Managing Director. In 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). The competition was slow to respond and UFCC still dropped the price by $100 per tonne in 1994, rapidly gaining market share. In 1994 UFCC shareholders had grown to more than 750 (Warren 2002, p. 22). In those early years UFCC ran a "Spartan" operation, with no storage facilities in order to keep handling costs as low as possible. Farmers would pick up their fertilisers from the port, which was becoming a logistically challenging exercise. In 1993 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.

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1995–1999: The Golden Era

This period is remembered by many former members as the "golden time" for UFCC. In 1994–1995 UFCC entered the chemicals market (pesticides), where again they delivered significant savings to their shareholders.

> The price of glyphosate came down from something like $18 to maybe $9 dollars a litre and we were making significant profit on that. (Source: interviews)

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. Shareholders increased exponentially wherever a new facility was opened. Founded with only five shareholders in 1992, UFCC grew to more than 1,750 shareholders by 1999 (Warren 2002, p. 37).

The key drivers of success include 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 to that, the co-operative was in this period run by a small, tight knit and competent management team that introduced new management systems and procedures to support financial management and administration. They further 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 (source: communication in writing).

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 CEO in 1998. As a result, Barden-Brown left in December 1998. In less than a year two more members of the long serving employed management team also left UFCC, leading to a complete change in management style. 1999 marked the establishment of the United Farmers Mutual and a grain division, the latter however remained stagnant until 2002 (source: interviews).

2000–2005: Full Service Provider

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). John Connell lost the board's trust and confidence and was replaced in 2002 by Tony Usher. The board and the CEO 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. 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.

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In 2003 UFCC further diversified into manufacturing (ammonium sulphate) through the Anaconda venture. However, some board members became increasingly uncomfortable with the progress of the new strategy. In 2003 the co-operative structure, the value of diversification, and the aim of growth vs. efficiency were all debated at board level (UFCC, 2003).

In 2002 Gary Cosgrove resigned from the Board and in 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 they 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). The new board chaired by Max Johnson continued to pursue the diversification strategy. In 2004–2005 UFCC did not issue a rebate to members for the first time since 1995, and the interest bearing debt increased from $14 million in August 2004 to $33 million in August 2005 (source: interviews and unpublished financial review).

2006–2008: Back to Basics

In the 2006 AGM members did not support Max Johnson as Chair and shortly after that the CEO resigned. The new board chaired by Bowe Wilson 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. Fertiliser sales accounted for 80% of revenue in 2006, however the other business units (manufacturing, chemicals sales, grain marketing, wool marketing) were still operational. In October 2006 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 the wool business, but as they could not find any buyers it was closed down. In 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 into exclusive discussions with Ravensdown, a New Zealand based fertiliser co-operative, and recommended a merger at the 2007 Annual Meeting. In January 2008 UFCC was merged into Ravensdown (Co-operatives WA 2008).

THE BUSINESS MODEL

As the preceding short history of UFCC 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 the following subsections we examine the UFCC business model and how it evolved over the life of the co-operative.

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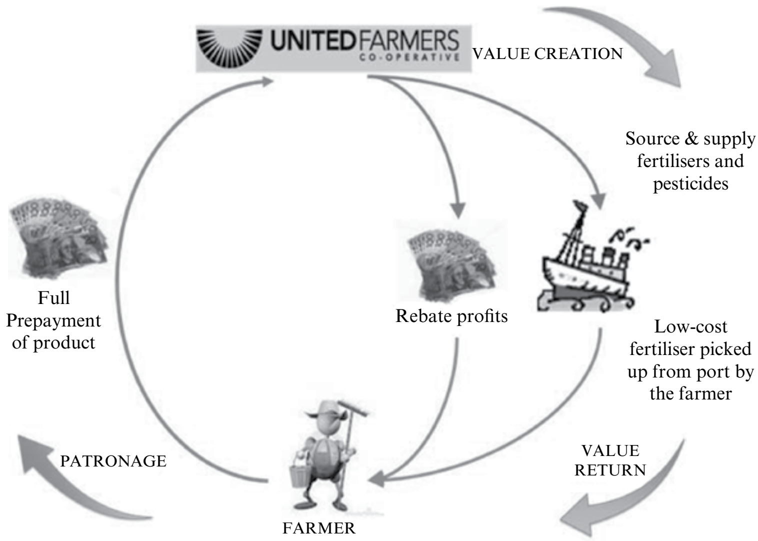

Figure 11.2 *UFCC business model "survival stage" 1992–94*

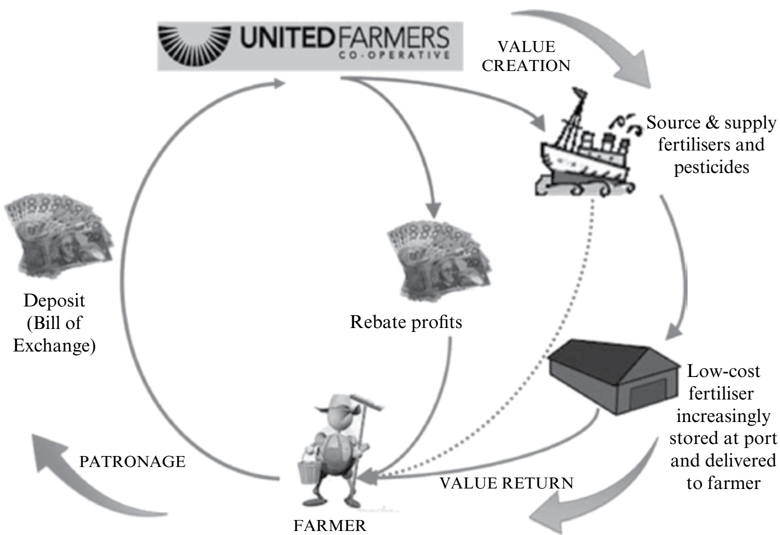

Figure 11.3 *UFCC business model "acceleration stage" 1995–98*

Three Stages of Growth

UFCC is an example of a farmer's co-operative formed as a result of market failure. In the early 1990s the oligopolistic fertiliser market in WA was one of the contributors to the wheat market failure. Fertiliser is the largest farm input cost and with pesticides currently accounts for over 30% of total farm input costs (West Australian Farm Inputs

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Taskforce 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 member value proposition (MVP) offered by UFCC was built on a cost leadership positioning strategy (Porter 1981). This was 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).

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

The year 1995 signalled a shift from the early infant stage into the second stage of development in the co-operatives' life cycle (Cook 1995). 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 1995–96 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 challenge associated with cost of debt, inventory accumulation and management when a large number of farmers simultaneously cancelled orders.

There were differing opinions amongst interviewees as to whether UFCC changed its strategy in the period 1999–2002. Some maintained 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 in wool processing and meat marketing had taken place as early as 1993 (Warren 2002, pp. 19–20). Although discussions and investigations of various business opportunities may have taken place at board level, the period 1995–99 is clearly dominated by a growth strategy focused on the core business of fertiliser and chemical supply. In 1999 and subsequently in 2002 new CEOs were brought in with mandates to diversify operations and "drought-proof" the business. The terms "full rural service provider", "crop protection" and "circle of service" appeared in the Tony Usher period from 2002 to 2004 to describe aspects of the differentiation strategy. In 2005 UFCC had evolved to a multi-purpose co-operative as illustrated in Figure 11.4.

Low-cost Fertiliser Provider: A Sustainable Business Model?

Would UFCC have been more resilient, had they remained a low-cost provider of fertiliser and chemicals only? This question emerged through the interviews as many shared the view that the diversification strategy was what impacted on UFCC's sustainability. Indeed UFCC made a quick move to a 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)

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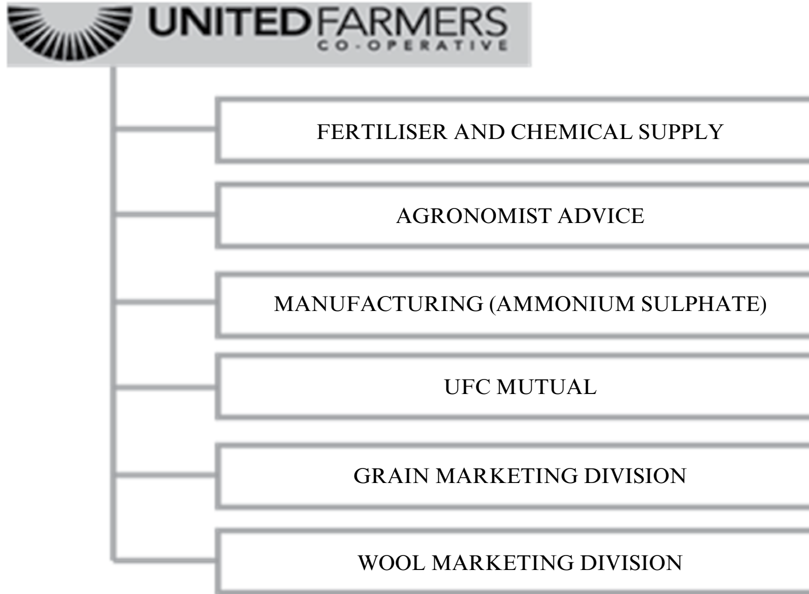

Figure 11.4 UFCC business model "diversified" 2005

very low profit margins; (ii) high environmental dependencies; (iii) inability to attract large growers, and (iv) powerful competitors.

Let us examine each of these issues. UFCC had low profit margins and a strong focus on maximising 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 then 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 (interviews; UFCC 2003). 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 (refer to Chapter 2 for an analysis of members' patronage, investor, owner and community roles). 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 (discussions with Rabobank, 2011).

UFCC's business model as a supplier of farm inputs was highly dependent on the natural environment, 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 in 2006–2007, coupled with high markets for 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

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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.

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 subsidised 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 for UFCC due to restructures driven by their competition), and was also not a priority or even desirable by many 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 its 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 indicate that they would most likely remain a smaller player in the industry, not achieving the economies of scale that their competitors could achieve.

UFCC's strategy also began to see a shift in 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. 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".

In conclusion, UFCC could possibly have become resilient as a low-cost provider of fertilisers and chemicals if it had targeted a niche market that the larger competitors were

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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 the change in strategy impacted on the 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.

Differentiation and Diversification Strategies

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 fertilisers that had been available in Western Australia was

> unsophisticated, unimaginative and was certainly nowhere near as innovative as most of the rest of the world. (Source: interviews)

UFCC employed an agronomist expert and in the course of 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.

However 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 its 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 through the interviews; as noted by some interviewees diversification projects seem to have been in some cases personality driven, in other cases 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 on 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)

The board had always aspired to diversify UFCC's operations and pursued an aggressive diversification strategy in the 2000s.

Diversification was certainly a reasonable strategic direction, which seems to follow a general trend in the WA agricultural industry at the time. A typical example is the 2002 merger of CBH (grain handling co-operative) and Grain Pool of WA (grain marketing agency) into the formation of what is today the largest co-operative in Australia (Co-operatives WA 2011). CBH further diversified in 2004 and 2005 with acquisitions of Asian flour mills which were later on proved to be invaluable in supporting CBH's profitability, offsetting the climatic 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. The following managerial and

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decision-making failures were detrimental to the implementation of UFCC's diversification strategy.

Diversifying into manufacturing

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 it 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 (source: interviews). At the time of writing the facility was still troublesome under the new Ravensdown management.

The long-term lease of the Kwinana Beach storage facility

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. The board signed the contract in December 2001. In hindsight, the envisioned throughput never materialised and this lease has proved to be a key driver of the increase in operational costs. Much later, Ravensdown was still dealing with a 200% more expensive per unit storage in comparison to competitors' costs in the Kwinana area (source: 2011 interviews). In addition to being a binding contract for 21 years, the agreement had a number of prohibitive conditions including make good clauses (e.g. repair and maintenance).

Doing too much too quickly with a lack of rigorous due diligence

UFCC overextended themselves into many areas simultaneously, under the board direction and Usher's management (2002–2005):

> [Usher] wanted the full service for rural based people, so wool, sheep, grain, fuel, insurance, whatever we produced or needed. (Source: interviews)

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)

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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)

Overinvesting in staff

In the diversification process UFCC employed too many staff when competitors were downsizing to remain competitive (source: interviews). In the Tony Usher period staff numbers grew significantly and so did associated overhead costs:

> In one year they went from 6 company cars to 40 . . . He 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. (Source: interviews)

Introducing "seasonal finance"

In 2005 UFCC introduced what they called seasonal finance, which was extended credit so that 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:

> Wesfarmers and CSBP [were] supplying fertiliser through Elders and Landmark and Elders and Landmark were carrying the finance risk, not the fertiliser 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. (Source: interviews)

That impacted on the financial bottom line in 2005, 2006 and 2007.

CO-OPERATIVE EVOLUTION THEORIES

Did Its Success Make It Redundant?

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 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.

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> 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 fertiliser 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)

This brings us to LeVay's second claim, the "pacemaker" theory. As survival becomes important for members they seek a *raison d'être* to maintain the co-operative, 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 (refer to the case of Murray Goulburn in Chapter 9), 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 in WA 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 indeed lost member loyalty because of its inability to maintain a competitive product offering that satisfied the initial purpose of delivering cost-effective fertiliser to its members. We will conclude that it was therefore 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.

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

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capital or pursue a proportionality strategy of internally generated capital; or (c) shift to 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, and started to become increasingly complex and scrutinised by members. However, we suggest that the property rights and agency theories are not 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; however this was due to member 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 intensified in 2003, leading to the resignation of the chairman and two board members in 2004. There is a view that the CEO at the time was a strong driving force for diversification and vertical integration (source: interviews); there is evidence however that this agenda was passed on to him from the board, which appointed him to deliver on diversification. The two previous CEOs' 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, the majority of the board was supportive of management initiatives and remained so until 2005. We therefore do not observe 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.

GOVERNANCE FAILURE

UFCC 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 UFCC. 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 of time.

CEO Turnover

The lack of corporate management experience at board level contributed to an inability to recruit, retain and effectively direct and supervise the right person in the position of

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CEO. UFCC turned over six general managers/CEOs in eleven years. In each case the new executive was greeted with early enthusiasm by the board, but this would soon be followed by a breakdown in the relationship for various reasons. A number of cases were related to a breakdown 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.

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-socialising" with their CEO, and the CEO approaching individual board members to get their support prior to bringing items to the board's attention (source: interviews). At other times, the opposite was the case, when 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 (source: interviews). 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 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. 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 key performance indicators (KPIs):

> What Usher 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

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> 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 actually not communicating effectively with the CEOs and was overriding 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 were 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 other agricultural co-operatives that recruit board members solely from the farmer 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 $5.05 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, as a whole the board was at times too weak to make a decision to drop an idea and move on.

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> 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)

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-operative" (UFCC 2003, p. 3). 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 management, and to review and adjust decisions that were financially less viable than initially forecasted. This led to the downfall of UFCC.

CONCLUSION

UFCC was a very entrepreneurial agricultural 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 notes as early as 1983 that the birth of agricultural co-operatives has often been almost immediately succeeded by their demise, identifying "lack of appreciation on the part of farmers of the risks involved in forward integration" as one of the key causes (LeVay, 1983). That was the case for UFCC, as both board and management were so 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.

The challenge of re-inventing the UFCC business model 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. As UFCC expanded its operations and developed its storage and distribution systems, the business model and MVP had to

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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.

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 questions should be:

1. will existing members value the added purposes and benefit from them directly? Or
2. will the co-operative 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 are 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 its purpose, that it was there for the members and needed to provide member value in both the short term and long term.

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