ORGANIZATIONAL CHANGE IN THE AUSTRALIAN GRAIN INDUSTRY: A COOPERATIVE LIFE CYCLE APPROACH

BY

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A Thesis Submitted to the Faculty of Graduate Studies
in Partial Fulfillment of the Requirements for the Degree of

MASTER OF SCIENCE

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Abstract

This thesis evaluates how well cooperative life cycle theory explains the evolution of five major organizations traditionally involved in the marketing and handling of Australian grain. Australia's grains industry has historically been subject to a significant degree of regulation whereby federal or state-based organizations were granted exclusive rights to operate on behalf of growers to market and handle their grain. Since deregulation began in 1989, there has been a significant degree of industry rationalization. Those entities that survived have pursued strategies of growth and diversification in order to remain viable in an increasingly competitive marketplace. In the process of adapting to deregulation, most of these entities have altered their organizational structures in a manner that retains the traditional cooperative principle of grower control but establishes tradable equity shares more characteristic of investor-owned firms.

Case study analysis suggests that the evolution of these Australian organizations is generally consistent with cooperative life cycle theory. Originally formed as a method to help growers counteract market failure problems, the organizations, after a period of relative stability, encounter difficulties as the domestic and international industry environment changes. In order to remain competitive, four of the five organizations examined have altered their property rights structures in a manner that retains grower control but establishes tradable equity rights to facilitate greater capital flexibility and grower access to accumulated equity. However, these hybrid grower-investor ownership structures have the potential for conflicts of interest between growers and investors. Such conflicts can create new difficulties for the organization that must be addressed in order for these grower-controlled ownership structures to be sustainable over the longer term.

Acknowledgements

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Table of Contents

List of Tables

List of Figures

Chapter 1 Introduction

1.1 Background

The Australian grains industry has historically been subject to a significant degree of regulation, in which statutory marketing, handling, and transportation arrangements presided over the industry for nearly half a century. Statutory arrangements in part originated as a response to the perceived disadvantages individual growers[1] faced in terms of their lack of relative market power and related market failure problems. Collective grower action through statutory marketing and handling organizations was intended as a means to help offset these disadvantages. These organizations operated like agricultural cooperatives, in which Australian grain growers collectively marketed and handled their commodities and shared the risks and rewards of the organization's activities, albeit with exclusive government-granted privileges.

1.1.1 Changes in the Australian grains industry

During the past few decades, an overall policy shift towards deregulation has occurred in Australia. As a result, regulations that once granted exclusive privileges to these marketing and handling organizations have increasingly been removed, and restrictions that previously separated marketing, handling, and transportation functions along geographic boundaries have been eliminated. Although some significant regulatory features remain, most notably the exclusive right to export Australian wheat in bulk,

[1] The Australian industry tends to refer to farmers as growers, and as such this particular terminology is maintained in this study.

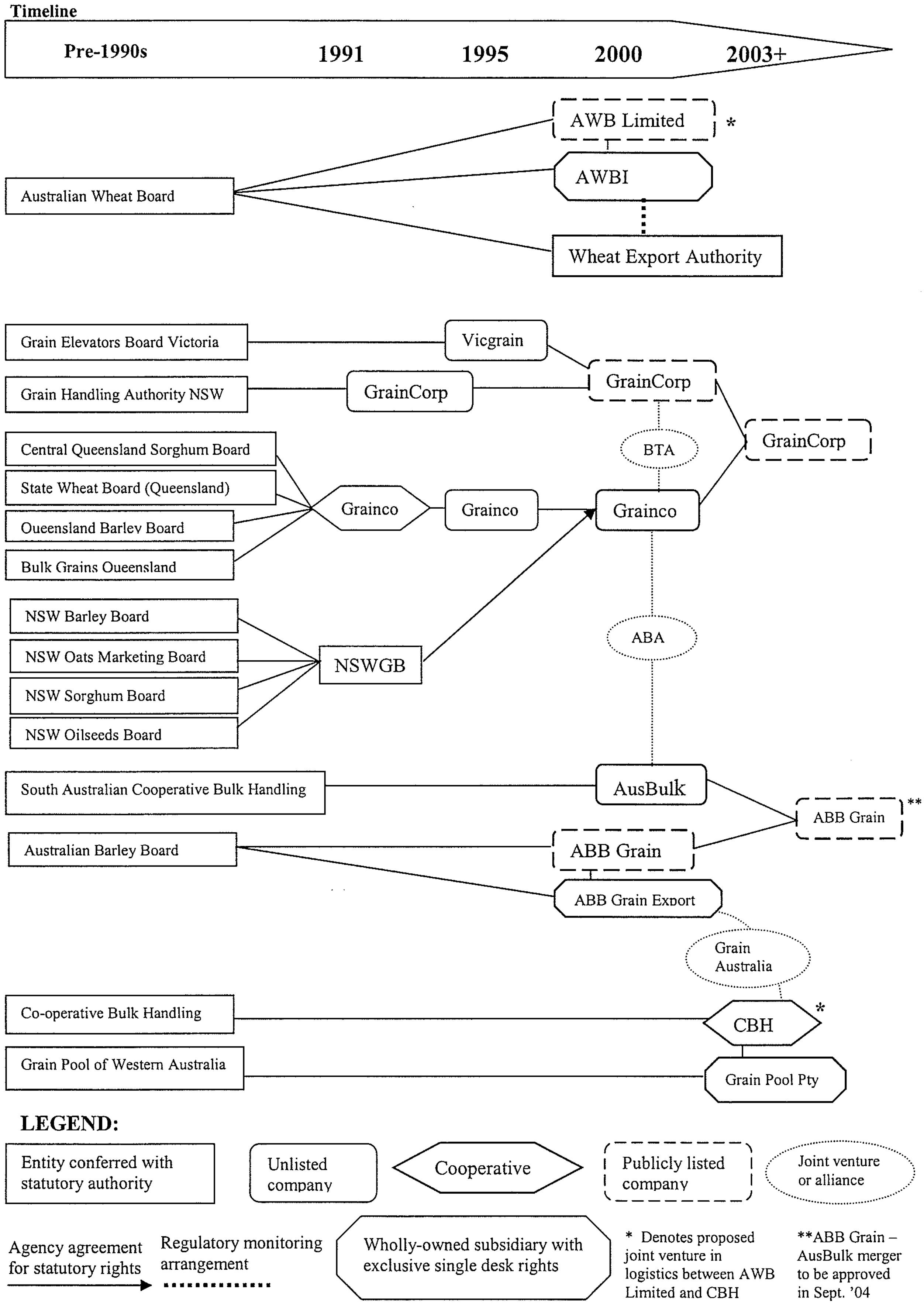
many industry stakeholders anticipate a future in which further deregulation will eventually take place.

The era of deregulation has witnessed major institutional and structural changes to Australia's traditional industry arrangements. At the forefront of these changes has been the transformation of 15 former statutory marketing and handling organizations into five private (i.e. non-government owned) agribusinesses that remain in operation in early 2004, namely: AWB Limited, ABB Grain, GrainCorp, AusBulk, and Co-operative Bulk Handling (CBH). The complex evolution of Australia's traditional grain marketing and handling organizations during this period is depicted in Figure 1.1[2].

Although they are all private companies, several organizations have retained exclusive government-granted 'single desk' marketing rights that are carried out on behalf of growers. The most significant of these is the export single desk for bulk Australian wheat, which is currently managed by AWB Limited, in particular its wholly-owned subsidiary, AWB (International) Limited (AWBI). Other government-granted single desk privileges include CBH's export marketing rights for Western Australia barley, lupins, and canola, as well as ABB Grain's export marketing rights for South Australian barley. These single desk privileges affect the relationships that currently exist among the organizations and Australian growers.

[2] Figure 1.1 also includes subsidiaries of the five restructured agribusinesses that retain exclusive government-granted marketing privileges, as well as various strategic alliances and joint ventures that have been established among the entities. Also, in May 2004 ABB Grain and AusBulk announced their intention to merge. The merged entity will be known as ABB Grain from September 2004 onwards, and this is also depicted in Figure 1.1.

Figure 1.1 Major organizational changes in the Australian grains industry



Formerly restricted by regulations to serve a particular geographic region or business function (such as marketing or handling), the five agribusinesses are broadening the scope of their operations in an attempt to gain efficiencies and stake out a position in an increasingly competitive marketplace. In this manner, these entities are aggressively pursuing strategies of growth and diversification, and in the process encroaching into geographic areas and business activities that were once considered the sacred domain of other statutory entities. Moreover, these agribusinesses are vertically integrating beyond their traditional handling and marketing segments by extending their involvement further along the supply chain, beginning with research and technology at the seed development stage and reaching all the way to downstream activities such as milling and malting. The momentum for change in Australia does not appear to have abated in early 2004, as the organizations continue to undertake strategic acquisitions and alliances and enter new areas of business activity. Moreover, these organizations are positioning themselves to prepare for a future in which further deregulation, most notably the removal of the export single desk for bulk wheat, is anticipated. If and when deregulation occurs, the Australian organizations want to be in a position to capture a share of the export market business. If deregulation of the export market occurs, these organizations anticipate aggressive competition from not only other Australian entities, but also larger foreign-based multinationals who have not previously had a significant presence in the marketing and handling of Australia's major grains, in particular wheat and barley.

1.1.2 Cooperative characteristics of the Australian industry

What is particularly striking about the evolution of Australia's former statutory marketing and handling organizations is the primary role of the Australian grower in determining their strategic direction. In this respect, although they each vary somewhat in terms of their current organizational structures, all five entities have maintained some degree of their traditional cooperative characteristics. In particular, all have adopted structures that maintain formal grower control of the organization through majority voting rights and governance arrangements. Grower control represents a fundamental principle of agricultural cooperatives, in which the users of the business – the growers – direct and control the organization's affairs to ensure it is run in accordance with their interests.

Although Australia's former statutory organizations have maintained their cooperative characteristics to some extent, they have also implemented changes that represent fundamental departures from the traditional cooperative model. In particular, several entities have adopted structures that allow non-grower investors to become shareholders in the organization. In this manner, equity ownership is no longer restricted to growers, and the organizations represent hybrid forms of grower cooperative-share capital corporations. These sorts of organizational innovations raise broader issues about the nature of cooperative organizations and their role within a dramatically changing agriculture industry. Given that cooperatives have traditionally been viewed as vehicles through which growers can collectively further their economic interests in the supply chain, changes to these organizations raise broader questions about whether growers' interests will continue to be served by these innovative structures.

1.1.3 The evolution of agricultural cooperatives

During the period in which Australia's former statutory entities were undergoing various transformations, similar organizational changes among traditional agricultural cooperatives were occurring elsewhere. Structural change among traditional cooperatives has been the subject of interest to various researchers who have questioned why these organizational transformations are taking place.

1.1.4 New institutional economics and cooperative life cycle theory

Cooperative organizational change has been examined from the perspective of new institutional economics, a field of study that encompasses transaction cost economics, agency theory, and property rights analysis to focus on various aspects of firm behaviour. In contrast to a traditional neoclassical approach, which focuses on profit-maximizing behaviour of abstract firms, new institutional economics focuses on the nature of the firm itself. New institutional economics provides an insight into the choice of organizational form and the evolution of alternative business structures over time (Royer, 1999).

A leading expert in the study of cooperative organizational change is Dr. Michael Cook of the University of Missouri-Columbia, whose work falls within the realm of new institutional economics. Based on his observations, Cook (1995) has developed a five-stage life cycle model to examine cooperative organizational change, which describes a cooperative's genesis, growth, and eventual decision to exit the industry or restructure in some manner. At the heart of Cook's framework is the notion that a traditional cooperative's property rights structure may have inherent weaknesses that limit its financial flexibility and create difficulties associated with managing the business relative to other forms of organization. Cooperative problems such as these have also been noted by other academics. These internal constraints may become particularly troublesome for a cooperative when external forces alter the broader industry environment in which it operates. In this latter context, factors such as the industrialization of agriculture, globalization, increasing industry concentration, and withdrawal of government support have all played a role in transforming agriculture in general during the past few decades. Although a cooperative's traditional property rights structure may have served the organization well in the past, it may no longer be the most suitable in an altered industry environment. Eventually the organization may decide to pursue one of several strategic alternatives that alleviate some of these perceived internal constraints. The life cycle framework proposed by Cook (1995), as well as supporting work done by other researchers in this area, will be presented in the study. This framework will then be applied to the Australian case studies, in order to determine whether their evolution and reasons for organizational change are similar to those suggested by the theory.

1.2 Objectives of the study

The objective of this research was to examine how and why Australia's traditional grain marketing and handling organizations have evolved in the manner in which they did, in order to contribute to a more general understanding of why many of today's grower-based organizations are adopting structures that no longer adhere to the traditional cooperative model. In this respect, this thesis evaluates whether cooperative life cycle theory helps explain the evolution of key organizations involved in Australian grain marketing and handling. The knowledge obtained in this thesis will be useful for those who have an interest in grower-based cooperative organizations, and more generally those who wish to see growers maintain some degree of influence over the organizations that handle and market their commodities in an increasingly industrialized and globalized marketplace. It is also hoped that this research will be useful for those who want a greater understanding of the complex competitive and regulatory dynamics currently at play in Australia's grains industry, and the significant institutional changes that have been undertaken in this important wheat and barley exporting country at the beginning of the 21st century.

1.3 Methodology

The thesis utilized a case study approach to investigate organizational change in the Australian grains industry within the context of new institutional economics, in particular cooperative life cycle theory developed by Cook (1995). The case studies examined five Australian organizations that have played a major role in the marketing and handling of Australia's two major grains, wheat and barley. The case studies examined each organization's evolution from its statutory beginnings to its current organizational structure and business strategy. The five organizations examined in this manner were: AWB Limited, ABB Grain, GrainCorp, CBH, and AusBulk. Case studies were prepared on the basis of information gathered from primary sources such as publicly-available company documents and statements made by company directors and executives, Australia's federal and state governments, and leading Australian grower lobby groups such as the Grains Council of Australia. Direct correspondence from stakeholders was also obtained. Supporting information was gathered from other sources such as Australia's prominent news reporting organizations and academics who have studied the Australian industry and related issues.

1.4 Organization of the study

The thesis comprises eight chapters. This chapter has introduced the study and identified its objectives. Chapter two presents a brief overview of the Australian grains industry in terms of the types and volumes of grains produced, farming operations, and the relative importance of export markets, so that the reader has a general understanding of the basic features that characterize the operating environment in which Australia's marketing and handling organizations function. Chapter three describes the origins and features of Australia's traditional statutory marketing and handling arrangements that presided for most of the 20th century, particularly in the context of Australia's most important grain—wheat—as these arrangements played a key role in shaping the organizations that exist today. Chapter four describes the shift towards deregulation that began in the 1980s, the institutional changes that were made at that time, and the pressures for further deregulation that continue to exist in 2004. Chapter five provides an overview of the main differences between cooperatives and investor-oriented forms of organization, as well as a review of new institutional economics and the relevant cooperative theory that is used as the basis for analysis in the thesis. Chapter six presents the case studies of the five Australian agribusinesses. Chapter seven analyzes the case studies in the context of the theoretical framework described earlier. The final chapter concludes the thesis with observations from the analysis and recommendations for further study in this area.

Chapter 2 Overview of Australian agriculture

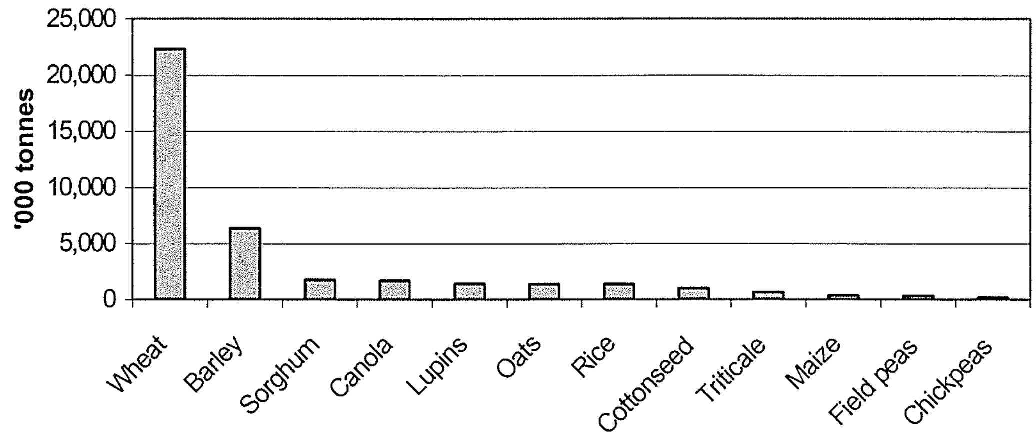
2.1 Introduction

This thesis focuses on five Australian organizations that have traditionally played a significant role in the marketing and handling of Australia's two major grains, wheat and barley. In order to understand the basic operating environment in which these organizations function, this chapter presents an overview of Australian agriculture, particularly the grains sector. Significant features include the prominent role of wheat and barley in terms of overall production, the relatively narrow growing region in which the bulk of grain production occurs, the country's centralized system of storage and handling, and the importance of export markets for Australian wheat and barley, including Australia's rank as one of the world's major exporters of these two grains.

2.2 Australian grain production

Grain is by far the most important agricultural commodity group produced in Australia (National Competition Council (NCC), 2003b). As Figure 2.1 indicates, wheat is the dominant crop grown in Australia, with barley following at a distant second. In the five-year period 1997-98 to 2001-02, wheat accounted for an average 57 percent of Australia's combined production of grains, oilseeds, and pulses. Average annual wheat production over this period was 22 million tonnes. Although the operations of the agribusinesses examined in this thesis are not limited to wheat and barley, the dominant role these two grains play in terms of overall volume of grain production signifies the strategic importance they hold for organizations that market and handle grain in Australia. Given its overall importance, industry operations are primarily built around the needs of wheat, which largely determines how other grains are stored and handled and how freight and storage rates are set (Accenture, 2003).

Figure 2.1 Australian grains and oilseeds production, five year average 1997-98 to 2001-02

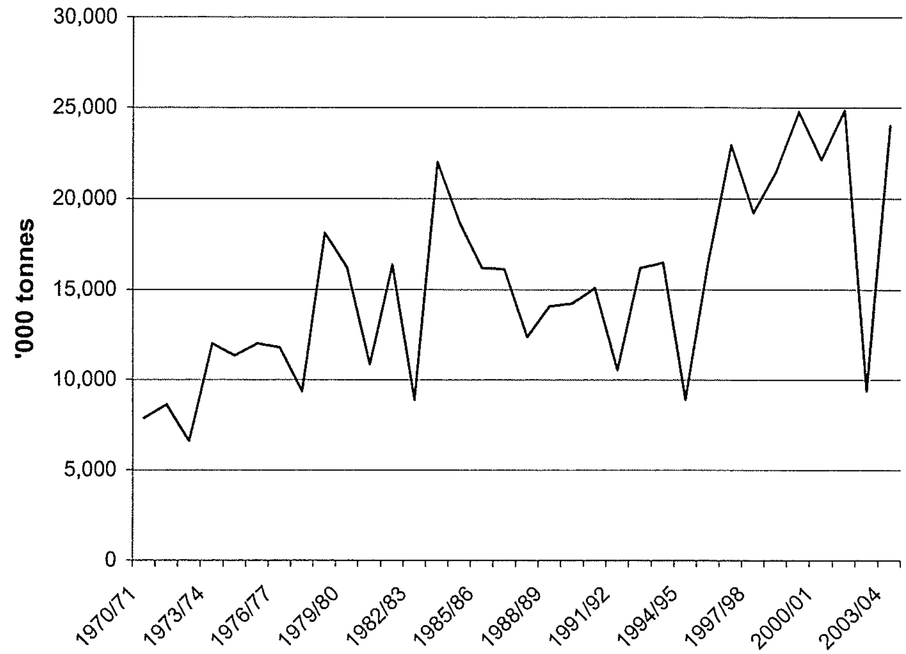


Source: Australian Bureau of Agricultural and Resource Economics (ABARE), 2002

Given the variable climatic conditions of Australia, in particular the occurrence of periodic drought, production levels can fluctuate considerably from year to year. As an example, the variability in annual wheat production is depicted in Figure 2.2, which charts Australian wheat production from 1970-71 to 2002-03, as well as preliminary production for 2003-04[3].

[3] The variability in Australian wheat production was most recently evident in 2002-03, when a severe drought across nearly all of the country's major growing regions caused wheat production to decline by 59 percent from the previous year. Production for 2003-04 was expected to rebound to almost 25 million tonnes (ABARE, 2004).

Figure 2.2 Australian wheat production, 1970-71 to 2002-03

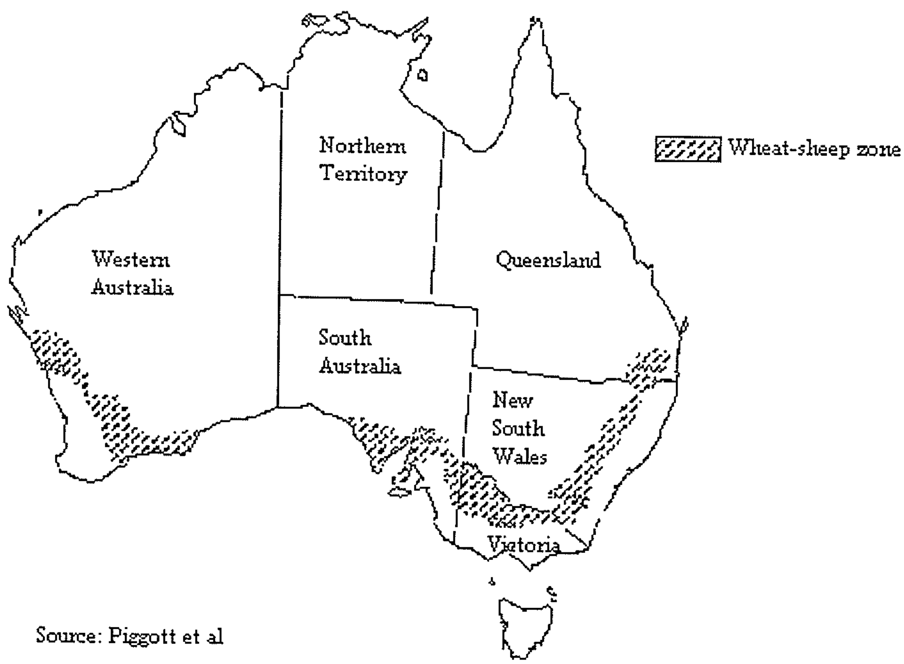


Source: United States Department of Agriculture, Foreign Agricultural Service (2004)

2.3 The wheat-sheep growing region

As Figure 2.3 indicates, the majority of Australian grain production occurs in a geographic area commonly referred to as the wheat-sheep zone, a narrow crescent-shaped area of land that runs near the coastline from central Queensland, through New South Wales, Victoria, and South Australia, and continues along the south-western portion of Western Australia. Barley is grown in approximately the same geographic area as wheat. The diversity in climatic and other growing conditions experienced throughout this area results in variations in grain types, growing seasons, and yields. Given Australia's variability in rainfall and growing conditions, its average wheat yields tend to be lower than that of other major exporting nations. Wheat is planted in the Australian autumn months, usually beginning in May, and harvested in early summer after a five- to sixmonth growing season. Harvest is usually completed by December, but the timing can vary throughout Australia because of weather conditions (Piggott et al, 1992).

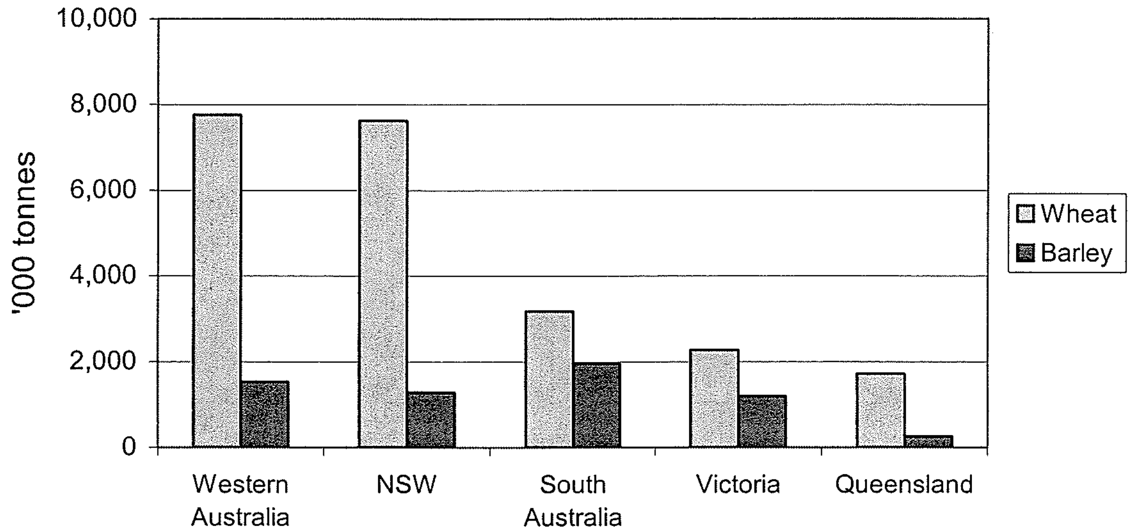
Figure 2.3 The wheat-sheep zone



2.4 Production by state

Although all Australian states except the Northern Territory produce some wheat, Western Australia and New South Wales contribute the most to production in a typical year. As indicated in Figure 2.4, Western Australia is the largest wheat-producing state, representing on average about 35 percent of Australia's annual wheat production. Western Australia has a greater reliance on exports than most other states, given its distance from the more populated eastern coast of Australia, where the majority of domestic consumption occurs. South Australia is the largest barley-producing state.

Figure 2.4 Wheat and barley production by state, five year average 1996-97 to 2000-01



Source: ABARE, 2001

2.5 Farming operations

Grain, wool and meat (primarily sheep and beef cattle) production comprise the three major components of Australian agriculture. The majority of farms involved in growing grains also have livestock operations, usually sheep or cattle or a combination of both. Wheat farming often involves extensive rotations with pasture, depending on relative prices of wheat, sheep, and wool. For instance, a grower may plant wheat a few years in a row and then pasture for several years afterwards. If wheat prices fall relative to sheep meat and wool prices, the grower may have an incentive to include a longer pasture phase in the rotation, and vice versa. For example, since the early 1990s, growers with mixed enterprises have reduced their sheep flocks and increased the area sown to crops, partly in response to low wool prices (Hooper et al, 2003). In terms of their relative contribution to average per farm cash receipts, wheat ranked first among several commodities during the period 2000-01 to 2002-03, as demonstrated in Table 2.1.

Table 2.1 Commodity contribution to average per farm cash receipts, 2000-01 to 2002-03

Commodity	Percentage contribution
Wheat	32
Barley	11
Wool	11
Sheep	11
Beef cattle	7

Source: Hooper et al (2003)

Similar to the trend in other major agriculturally-developed nations, Australian farms have increased in size and fallen in number over the years. Between 1977-78 and 2001-02, the number of grain-producing farms fell by a third while the average area per grain farm increased by 34 percent (Hooper et al, 2003). In 2000-01, Australia was estimated to have 29,916 farms involved in grain growing. In that year, average farm size varied among states. Western Australia led the pack, with an average farm size of 2,515 hectares producing 1,179 tonnes of wheat. New South Wales followed, at an average farm size of 1,860 hectares and average wheat production of 708 tonnes. Victoria was the smallest state in terms of farm size, at 926 hectares, and an average wheat production of 457 tonnes (ABARE, 2003).

Most grain, including wheat, is delivered to Australia's commercial storage system as soon as practicable after harvest. As a result, the storage and handling system in each state must be capable of accepting an average crop volume within a relatively short harvest period each year[4]. Although on-farm storage of grain in Australia has

[4] As an example of the commercial capacity required in such arrangements, CBH, Western Australia's major bulk handling organization, is undertaking a plan to equip its storage and handling system with the ability to receive 15 million tonnes of grain in just 21 working days by 2005 (CBH, 2002).

traditionally been very limited, it has been increasing in recent years (AWB Limited, 2001a; Wilson and Orr, 1989).

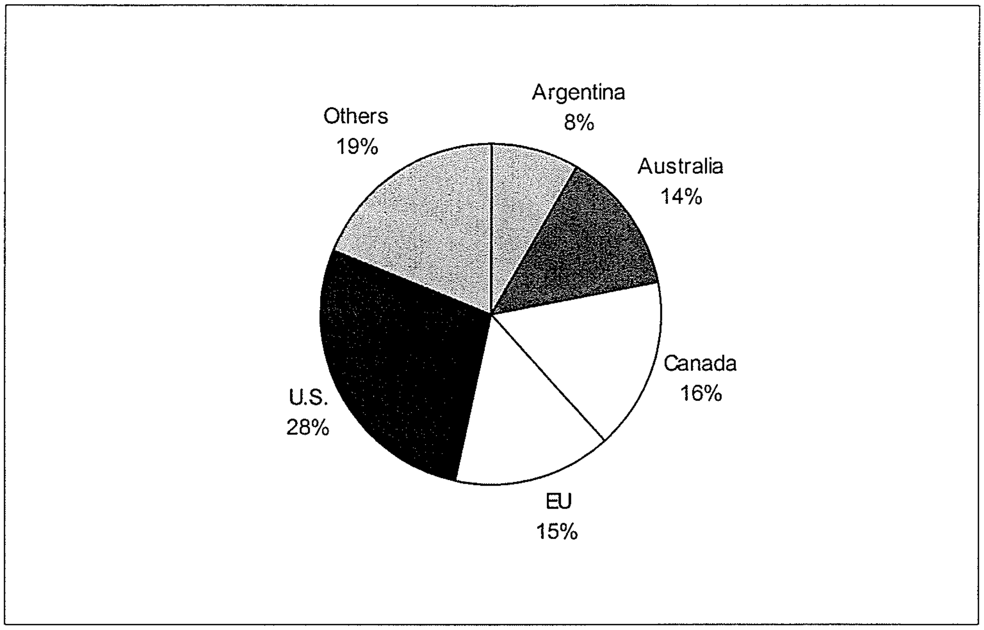
2.6 Domestic use and exports

The Australian grains industry is heavily dependant on export markets. In recent years, Australia has exported around 60 percent of its overall grain production (Hooper et al, 2003). In terms of wheat, Australia's domestic consumption remains relatively stable at between 4 and 5 million tonnes, of which approximately 2.6 million tonnes is used for human and industrial consumption, with the remaining used as livestock feed. As a result, the country relies on exports to move the majority of its production. For example, given high production levels in the late 1990s, Australia relied on exports to move approximately 70 to 80 percent of its wheat production each year (Cracknell and Williams, 2000; Scales, 2003).

Although Australia represents only three percent of the world's average annual wheat production, it ranks among the world's top five exporters[5]. As Figure 2.5 indicates, over the ten-year period 1993-94 to 2002-03, Australia ranked fourth in terms of average exports, representing almost 14 percent of the world's wheat trade (Canadian Wheat Board, 2003). Australia also plays a significant role in terms of world barley trade. In recent years, Australia has been the world's second-largest barley exporter, behind the EU. Australia accounts for around 50 percent of the world's exports of malting barley and 15 percent of feed barely exports (Cracknell and Williams, 2000).

[5] The world's top five wheat exporters have traditionally been the U.S., EU, Canada, Australia, and Argentina.

Figure 2.5 Percentage of world wheat trade, 10-year average 1993-94 to 2002-03



Source: CWB, 2003

2.7 Summary

As this chapter has demonstrated, wheat and, to a lesser extent, barley production play a significant role in Australia's grains industry. Most grain is delivered shortly after harvest, and as such Australia's centralized storage and handling system is capable of accepting large crop volumes in a relatively short harvest period each year. Given its relatively small domestic population, Australia remains highly dependant on export markets and consistently ranks as one of the world's top exporters of wheat and barley.

Within this operating environment, statutory marketing and handling arrangements played a significant role in shaping the Australian grains industry, including the organizations that remain today. The statutory beginnings of these organizations, including the history of their exclusive marketing and handling rights, are the focus of chapter three.

Chapter 3 Institutional arrangements in Australian grain marketing and handling prior to 1989

3.1 Introduction

As with other sectors of the Australian economy, agriculture has historically been subject to a significant degree of regulation. From the 1920s until the 1990s, the most prominent feature of Australian agricultural marketing arrangements was the involvement of over 50 state and 10 federal statutory marketing authorities (Piggott, 1990). Regulatory intervention was based on the notion that growers were disadvantaged in terms of lack of market power, exploitation by middlemen, and excessive marketing costs. Collective grower action in the form of statutory marketing authorities was intended as a means to offset these disadvantages (A.S. Watson, 1999). Marketing, storage and handling, and transportation activities were dominated by a number of national and state marketing authorities, as well as statutory bulk handling authorities and railway authorities in each state. Although private marketers existed for some minor grains, their role in the major grains such as wheat and barley was not significant.

The purpose of this chapter is to present an historical overview of Australia's statutory grain marketing and handling arrangements. This overview is necessary in order to understand the origins of the five major Australian agribusinesses examined as case studies, and how their structures and business activities have evolved to where they are in 2004. The chapter focuses on the role of the flagship Australian Wheat Board (AWB)[6] and the states' bulk handling authorities, all of which were designed to operate

[6] For Australia's second major grain, barley, each mainland state had its own statutory marketing authority which held an exclusive right to market barley (and often other coarse grains) on behalf of growers, both

on behalf of growers. A highly regulated marketing, storage, handling, and transportation system characterized the Australian industry for decades, and played a key role in shaping the industry as it exists today. Chapter four will examine Australia's shift towards deregulation that began in the 1980s. As the case studies will later demonstrate, major organizational changes began to occur after this shift began.

3.2 Origins of statutory marketing arrangements

Australia's statutory arrangements evolved from early 20th century efforts by growers to form cooperative marketing organizations (Productivity Commission, 2000a). Cooperative formation reflected concerns among Australian growers about middlemen profiteering and unstable farm returns (Piggott, 1990). Cooperative-based organizations were designed to move growers' product to market and influence price and other terms of trade, in a manner that provided fair treatment and other benefits to the organization's members. More generally, cooperative endeavours represented the efforts of individual growers to enhance and protect their position in the overall economic organization of agriculture (Torgerson et al, 1997). However, these voluntary cooperatives were subject to the free rider problem[7] frequently associated with such forms of organization, in which growers who did not join the cooperative benefited from its efforts without contributing to its costs of operation. As a result, growers lobbied government to make grower participation in cooperative activities compulsory (Piggott, 1990). Combined with other circumstances occurring in Australia during this period, most notably post-World War I

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domestically and abroad (NCC, 1999). As these entities behaved in a similar fashion to the orderly marketing arrangements of the AWB, they will not be described separately in this chapter. However, the evolution of the most significant of these entities, the Australian Barley Board (ABB), will be described in the case study of ABB Grain (presented in chapter six).

[7] The cooperative free rider problem is further examined in chapter five, section 5.4.2.3.1.

commodity price collapses, increasing grain production levels, and government protection provided to other economic sectors such as manufacturing, this pressure led to the introduction of statutory marketing arrangements beginning in the 1920s.

Australia's statutory entities essentially operated as compulsory cooperatives[8] (Piggott et al, 1992). A major objective behind the introduction of these arrangements was to maintain grower control of the marketing function, and to increase growers' collective market power (Productivity Commission, 2000a; NCC, 2003b). Given their grower-oriented characteristics, growers perceived these statutory entities as different from private firms. A.S. Watson (1999) describes this perception as follows:

> Farmers do not see themselves as purchasers of marketing services from statutory marketing authorities in the same way as marketing services or inputs purchased from private firms. Instead, farmers regard statutory marketing authorities as operating on their behalf...Creation of statutory marketing authorities reflected fears in the farming community concerning the efficiency and conduct of agricultural marketing. The AWB and other statutory marketing authorities cannot be thought of merely as marketing institutions (A.S. Watson, 1999: 446).

Cooperative ideology characterized Australia's statutory entities: growers perceived these organizations as representing their interests in the industry, and grower control and so-called 'compulsory cooperation' were main features of the industry.

3.2.1 Compulsory cooperation: The concept of orderly marketing

Compulsory cooperation is based on the concept of orderly marketing, i.e. removing competition between growers in the output market[9] (Ireland, 1998). Rather than competing with each other when selling their commodities, orderly marketing

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[8] A similar organizational example can be found in Canada: Traditionally viewed as a sister agency to the AWB (Carter and Wilson, 1997), the Canadian Wheat Board is not a cooperative in a legal sense, but has many of the characteristics of one (Oleson, 1999).

[9] C.F. Wilson (1978) provides a similar definition of orderly marketing, describing it as any board or collective market system, as differentiated from the open or competitive market system.

implies that growers collectively pool their commodities and behave as if they are one single seller. As such, orderly marketing is sometimes referred to as 'single desk' arrangements. These arrangements are intended to provide growers with greater market power when selling their goods than they would otherwise have as individuals selling independently from one another. In terms of mainstream cooperative thinking during this period, Australia's statutory orderly marketing arrangements reflected an approach advocated by prominent cooperative leader Aaron Sapiro, who contended that growers could correct imbalances in market power and grower treatment by organizing themselves along commodity lines (Torgerson et al, 1997). Carried out through entities such as the AWB and the ABB, orderly marketing dominated Australia's grains industry for over fifty years. In some cases, most notably for Australian wheat exports, orderly marketing remains in 2004, although the organizational arrangements through which it is carried out have changed.

In the early years of Australia's statutory marketing arrangements, orderly marketing involved a commitment both to a particular set of principles and to a certain institutional framework. The underlying principles were grower equality, the sharing of risks, and the related notion of price stabilization. Orderly marketing for wheat was implemented through an institutional framework comprised of a marketing organization, the AWB, which managed a compulsory pooling scheme as well as government-guaranteed pricing arrangements (Whitwell, 1993b). These features remained relatively unchanged for decades.

3.3 Australian wheat marketing arrangements, 1914 - 1989

Given the importance of wheat in terms of the nation's overall grain production, one of the most significant statutory institutions was the AWB, which operated as the exclusive marketer of Australian wheat both domestically and abroad for nearly fifty years. In this capacity, the AWB also had a significant influence on the development of Australia's bulk handling organizations, as one of their major responsibilities was to carry out the physical logistics of receiving and handling wheat on behalf of the AWB. A general understanding of the AWB's history highlights the main reasons why statutory arrangements were introduced, as well as the major features that characterized the industry until significant changes began to be made in 1989.

The federal government's first involvement in Australia's wheat sector occurred during World War I, when it used its emergency wartime powers to establish compulsory wheat pools in 1914 that were administered by an AWB. However, the government had promised grain merchants that private trading would resume after the war, and the compulsory pooling system was discontinued after the 1920-21 season (Connors, 1972). Private trading and voluntary grower cooperatives operated in between the two World Wars. During this period, various short-term financial aid was provided to growers, but governments were reluctant to implement organized marketing and price guarantee arrangements. In the Depression era of the 1930s, the Australian government exacerbated the country's agricultural and economic problems by encouraging growers to increase wheat production, as it wanted to increase exports (and therefore generate more foreign exchange) to improve Australia's significant balance-of-payments problems. However, world wheat markets were already suffering from excess supply, and although the government promised to provide wheat growers a guaranteed price, it failed to meet this promise because of financial and legislative difficulties. Australian growers consequently suffered through a period of low returns (Whitwell and Sydenham, 1991).

In 1939, with the outbreak of World War II, the AWB was re-established through emergency wartime legislation as a statutory authority, charged with the power to be the national and international marketer of Australian wheat on behalf of growers. In addition, the AWB was responsible for providing financing to growers at harvest time: Underwritten by the government, the AWB provided advance pool payments to growers at time of delivery and further payments throughout the year as sales were made (Piggott et al, 1992).

The experience of the Depression had left many Australian growers sceptical of the stability provided by the open market. Given this scepticism, growers were reluctant to reject government stabilization arrangements once the war was over (Connors, 1972). After the end of World War II, the AWB continued to operate under temporary defence-related legislation until 1948, at which time the federal *Wheat Industry Stabilization Act 1948*, along with the requisite complementary state legislation[10], was passed. The passage of the 1948 legislation signified the beginning of a long-lasting set of statutory arrangements for the marketing of Australian wheat, in which AWB would continue to be the exclusive marketer on behalf of growers. The legislation included a sunset clause which stipulated that, five years subsequent to its inception, the marketing arrangements

[10] Because of Australia's constitutional arrangements regarding federal-state jurisdictions, national grain marketing arrangements depend on the enactment of complementary state legislation. In particular, the passage of state legislation gives effect to Commonwealth marketing legislation within individual states.

would be subject to review and re-negotiation between the federal government and Australia's main grower lobby group, the Australian Wheatgrowers' Federation (AWF)[11]. Accordingly, subsequent to the 1948 legislation, Australia's statutory wheat marketing arrangements continued through the passage of 'Wheat Industry Stabilization' Acts in 1954, 1958, 1963, 1968, 1974, and 'Wheat Marketing' Acts in 1979 and 1984. The contents of each successive piece of legislation were negotiated between the federal government and the AWF. The inclusion of a legislative sunset clause was discontinued in 1989.

3.3.1 Major features of statutory marketing arrangements, pre-1989

Australia's wheat marketing arrangements continued relatively unchanged from 1948 until 1989, when significant legislative changes were made. Several main features characterized statutory marketing arrangements during this period: administered pricing; a stabilization fund; compulsory pooling; and the exclusive marketing role of AWB, both domestically and abroad. In terms of pricing, until 1989 Australia's domestic price for wheat was administratively-set, and for many years was largely determined in accordance with growers' cost of production figures. This was done to ensure that growers received a 'fair' return from domestic wheat sales that covered their average production costs. Connors (1972) contends that the cost of production formula used to set administered prices was a tool that could be manipulated to justify a price that was politically acceptable to the government and the AWF. The use of administered pricing for wheat was consistent with Australia's protectionist policies in other economic sectors during

[11] The AWF was later re-named to the Grains Council of Australia (GCA), as it continues to be known in 2004.

this period, most notably its manufacturing sector, which received a high degree of protection in the form of import tariffs. As long as the domestic manufacturing sector benefited from tariff protection, a general belief held by Australian growers was that they too should be given similar government protection from global forces (Whitwell and Sydenham, 1991).

Along with administered domestic pricing, wheat marketing arrangements included the use of a stabilization fund, the purpose of which was to make up any differences between a guaranteed price for a stipulated quantity of exports and world market prices, in order to stabilize returns that would ultimately be distributed to growers through AWB pooling. If the average export market price exceeded the guaranteed price, then an export stabilization tax was imposed on the difference between the two prices and the proceeds were place in the fund. Conversely, if the guaranteed price exceeded the average export price, then the difference between the two would be covered by the fund. If money held in the stabilization fund was depleted, then the Australian government would be responsible for making up the difference. Because of the tendency for the guaranteed price to exceed average export market prices, the fund was depleted by 1959-60, and the government began directly subsidizing the fund. These stabilization arrangements in effect acted as assistance provisions that transferred some of the risk of adverse price movements away from growers to the Australian government[12]. In 1979, the stabilization fund was replaced with an AWB guaranteed minimum delivery price, in which the government guaranteed a price to growers equal to 95 per cent of the average

[12] As a result of the stabilization arrangements, between 1948-49 and 1978-79 income was transferred from taxpayers to growers in 14 out of 31 years (Longworth and Knopke, 1982).

of the estimated pool return for the current season as well as the two previous seasons. In this manner, the guaranteed minimum price was a combination of current market expectations as well as past results.

Compulsory pooling was the process by which AWB marketed Australian wheat and distributed the net returns to growers. Pooling is a distinctive cooperative method of marketing, in which growers' commodities are pooled together and marketed by a single entity. Growers receive the average net pool return generated by the organization's marketing efforts. Pooling is designed to ensure an equitable distribution of marketing returns and risks among growers (Jermolowicz, 1999). Within the AWB system, all sales proceeds were pooled together, from which all administrative, transport, handling and storage charges were deducted, in order to determine the net return to growers. As a result of this pooling arrangement, all growers were paid the same, regardless of their individual location in the country relative to delivery or export point, or the timing of their delivery. Because of this latter point, growers had an incentive to deliver their wheat to the storage and handling system as soon as possible after harvest, as delivery was required to receive AWB's advance pool payment[13]. The nation-wide pooling of both revenues and costs was a method used to achieve the policy objective of grower equality, which lay at the heart of the orderly marketing arrangements for wheat (Whitwell and Sydenham, 1991). Under this pooling system, growers collectively shared the risks and returns of marketing Australian wheat, albeit with federal government

[13] In this manner, the advance payment arrangements influenced the development of Australia's centralized bulk handling system. Because growers had an incentive to deliver as soon as possible in order to receive the advance payment, this encouraged the development of a centralized bulk handling system that was capable of handling and storing the vast majority of the crop shortly after it was harvested (Cracknell and Sing, 2000).

support in the form of administered prices and stabilization arrangements. All net returns were distributed to growers, as AWB did not have the authority to accumulate significant capital reserves.

Australia's wheat grading system during this period also facilitated general pooling arrangements. Prior to 1974, almost all Australian wheat was marketed under a single quality classification known as 'Fair Average Quality' (FAQ). As a result, formal segregation of wheat within the AWB pooling system according to quality was essentially non-existent for many decades, meaning that growers would receive the same pooled return per bushel, regardless of the type or quality of wheat they individually produced. The FAQ system eventually gave way to a new classification system in 1974, although the class that replaced the former FAQ—Australian Standard White (ASW)—remained as the dominant class, comprising over 70 per cent of all Australian wheat deliveries (Whitwell and Sydenham, 1991). Several other classes (including Prime Hard, Hard, Soft, and Durum)[14] were also introduced in 1974. AWB began to offer different guaranteed minimum payments to growers for different classes of wheat in 1984, thus ending the traditional practice of paying all growers the same regardless of the type of wheat delivered.

3.4 Bulk handling authorities

In addition to marketing, Australia's storage and handling sector was also highly regulated, with bulk handling authorities established in each state. The origins of Australia's major bulk handling organizations are described in this section.

[14] These classes, along with several newer ones, comprise Australia's current wheat classification system.

Similar to the early histories of other agriculturally-developed nations, Australia traditionally stored and transported its wheat in bags. Compared to countries such as the U.S. and Canada, however, Australia was slow to make the transition from bags to bulk handling of grain. A major reason for the relative delay was concerns about infrastructure costs. In order to encourage the transition to a more modern system, government support to help finance the construction of bulk handling facilities began in 1915, but significant levels of debt were also incurred. However, grower use of the system was voluntary, and these early facilities found it difficult to achieve sufficient capacity utilization rates[15]. Unlike the bulk handling systems of countries such as Canada and the U.S., which relied more heavily on the use of on-farm storage and gradual deliveries to the commercial system throughout the year, Australia constructed centralized facilities that could hold the entire crop shortly after harvest and until it was sold.

In order to ensure adequate utilization of the new bulk handling facilities, and consequently the payment by growers of handling fees to help repay the debt involved (including the repayment of government loans) in constructing these facilities, regulations were established in each state that made delivery of wheat, barley and other major grains to the bulk handling system compulsory. State-owned bulk handling authorities or grower cooperatives were established in all major grain-growing states and granted exclusive statutory rights, beginning with New South Wales in the 1930s and ending with South Australia and Queensland in the 1950s. State legislation defined the powers and

[15] For example, Whitwell and Sydenham (1991) note the following about the first state (New South Wales) to introduce a bulk handling system: "Country silo capacity was rarely utilized and this accentuated the massive capital costs. A major stumbling block appeared to be the non-compulsory nature of the scheme. By 1933 only 50 per cent of the wheat grown in New South Wales was handled in bulk and the debt incurred in establishing the system had been considerable. Knowledge of the problems in New South Wales made other states cautious" (96-97).

functions of the bulk handling authority (BHA) and the composition of its board of directors. With the exception of Victoria, the governing board of each state's BHA was comprised of a majority of growers, which ensured grower control of these organizations[16]. State legislation also identified various social objectives the BHA was required to pursue. For example, Western Australia and South Australia required their respective BHAs to practice non-discrimination between growers, and Victoria stipulated that its BHA was to 'afford all reasonable proper and equal facilities for the storage of grain'. The interpretation of these sorts of social obligations was sometimes ambiguous, as the legislation was not sufficiently clear as to how these objectives could be met.

State legislation authorized its BHA to store and handle, both in the country and at port, the majority of grain produced in the state. Competition in the storage and handling sector was only permitted for smaller-volume grains. As a result of these regulatory arrangements, in the mid-1980s it was estimated that five state-based BHAs handled at least 75 percent of Australia's annual grain production (Royal Commission into Grain Storage, Handling and Transport, 1988). Table 3.1 lists the five state BHAs. As Figure 1.1 depicted, and as the case studies in chapter six will demonstrate, these BHAs have evolved into three organizations that continue to exist in 2004, namely: GrainCorp, AusBulk, and CBH.

[16] Some states also allowed for the appointment of a minority number of ministerial nominees who would bring to the board various types of marketing, financial, scientific or commercial skills.

Table 3.1 Australia's bulk handling authorities prior to 1989

State	Bulk Handling Authority
Queensland	Bulk Grains Queensland*
New South Wales	Grain Handling Authority*
Victoria	Grain Elevators Board*
South Australia	South Australian Co-operative Bulk Handling**
Western Australia	Co-operative Bulk Handling of Western Australia**

*Statutory authority
**Grower cooperative granted exclusive statutory rights

3.4.1 Bulk handling arrangements for wheat

Each BHA was granted exclusive rights to act as the sole receiver of wheat in the state on behalf of the AWB. In this capacity, the BHAs were responsible for receiving and storing wheat as well as country and port elevation. The majority of grain in Australia was delivered to the BHAs at harvest or within several weeks of harvest. As a result, BHAs required a capacity capable of handling and storing the peak harvest volumes. AWB took ownership of the wheat at the point of delivery by the grower to the BHA and set the receival standards for the grain, while the BHAs provided the physical functions of storing and handling at both country and export points on behalf of AWB. Extensive storage and handling agreements between the individual BHA and AWB outlined the provisions of services and relationship between the two entities. Prices charged for handling and storage services were largely determined by the BHA's cost structure: Each BHA would annually assess its costs and estimate its output, and then determine its prices for handling and storage based on this information (Wilson and Orr, 1989). Rates charged by the BHAs varied considerably among states (Royal Commission into Storage, Handling and Transport, 1988). Handling and storage charges for wheat were pooled on a national basis until the late 1970s, at which time state-wide pooling was implemented instead (A.S. Watson, 1999).

3.5 Transportation

In addition to marketing, storage and handling, Australia's grain transportation arrangements were also highly regulated and dominated by state rail authorities. Road transport was limited either by state legislation or administrative arrangements, and therefore did not play a significant role in grain movement relative to rail (Royal Commission into Grain Storage, Handling and Transport, 1988). Coordination between states in terms of transportation regulation was limited. In some cases, the gauge of rail track varied between adjacent states, thus preventing any effective linkages across state borders. As a result, grain transportation tended to be restricted to the state in which the grain was produced. Given these arrangements, grain destined for export would not necessarily flow to the nearest or cheapest port (Cracknell and Sing, 2000)[17].

3.6 Summary

For decades, Australia's grains industry was dominated by marketing and bulk handling organizations that were established to operate on behalf of growers. Legislation removed competition by granting these organizations exclusive rights to operate in a particular geographic region and market or handle particular commodities. Furthermore, legislation mandated grower control of these organizations through grower-dominated governance structures. Through these arrangements, grower control and compulsory

[17] Similar to the grain marketing, storage and handling sectors, transportation has also been subject to significant deregulation in recent years. Transportation deregulation is not addressed in detail in this thesis.

cooperation characterized the industry for decades. Beginning in the 1980s, however, a shift in policy emphasis gradually began to occur, as concerns about stabilization and equality among growers gave way to concerns about efficiency and grower responsiveness to market signals within the system. As a result, significant changes began to be made to Australia's regulatory arrangements in 1989. These changes substantially altered the competitive environment and led to significant organizational changes within the industry. The shift towards deregulation, and the changes that resulted, are examined in chapter four.

Chapter 4 Deregulation in the Australian grains industry

4.1 Introduction

The previous chapter described the major statutory marketing and handling arrangements that presided for nearly half a century over the Australian grains industry. The purpose of this chapter is to describe the deregulatory changes that began in the late 1980s and the impetus behind these changes. Deregulation altered the industry environment by removing certain statutory privileges from Australia's marketing and bulk handling entities, thereby creating a more competitive environment. As the case studies in chapter six will demonstrate, since deregulation began various structural changes have been made among Australia's traditional marketing and handling entities.

Although changes began in 1989, pressures for further Australian deregulation remain in 2004, most notably pressures to reform the single desk export marketing arrangements for bulk Australian wheat. The current industry arrangements, including pressures to reform the single desk, have created tensions among the industry's stakeholders, and there is considerable uncertainty about what changes, if any, will be made in the next several years. As these ongoing pressures have a significant influence on the organizations examined in this thesis, they are also described in this chapter.

4.2 Factors influencing deregulation, pre-1989

In order to fully understand the ongoing evolution of Australia's grain marketing and handling organizations, one must consider the broader forces that influenced a fundamental shift towards deregulation in Australia in the 1980s and beyond. In this respect, a general shift in approach to Australian policymaking, as well as specific industry-related events during the late 1970s and 1980s, are significant. Several authors, including Whitwell and Sydenham (1991); Ryan (1994b); Wait and Ahmadi-Esfahani (1996); and Martin (1990) have identified various factors that influenced a push towards deregulation. The most significant of these factors are summarized in Table 4.1 and described in sections 4.2.1 to 4.2.3.

Table 4.1 Key factors influencing Australian deregulation in the 1980s

Key Factor	Description
Shift in approach to government policymaking	Australian policymaking shifted away from Keynesian approaches towards 'economic rationalism' that favours less government intervention. Reforms included cuts in manufacturing tariffs, floating of the Australian dollar, and privatization of banking, transport, and telecommunications sectors. The Industries Assistance Commission reviewed wheat marketing arrangements in 1978, 1983, and 1988 and recommended domestic deregulation and greater flexibility in marketing arrangements. The Royal Commission into Grain Storage, Handling and Transport recommended deregulatory changes in 1988, including removal of bulk handlers' sole receival rights, ending the practice of cost pooling, and corporate restructurings (including privatization) of bulk handlers.
Farmer opinion	Some prominent farm leaders became increasingly critical of industry arrangements. Internal conflicts within Australia's leading grower group, AWF, hindered its ability to influence government policy.
International factors	Australia negatively affected by grain subsidy battle between U.S. and EU; hoped for greater free trade agreement from the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) negotiations.

4.2.1 Shift in approach to government policymaking

Deregulation in Australia's agriculture sector in the late 1980s was part of a broader shift in policymaking throughout Australia that affected various other sectors of the economy. Viewed in this context, the institutional changes that began to take place in the grains sector from the late 1980s onward were entirely consistent with regulatory shifts that were occurring elsewhere.

Since the end of World War II, Australian policymaking had been primarily characterized by Keynesian full employment goals and protectionist policies designed to nurture the young country's manufacturing sector. However, from the mid-1970s onwards, adherence to Keynesian approaches in policymaking gave way to a preference for what is described as 'economic rationalism' (Whitwell, 1993a; Pusey, 1991; Bell, 1998). The 1970s and early 1980s were marked by an onset of economic difficulties for Australia, in which the country experienced a marked increase in unemployment and negative growth in real GDP. Believing that traditional Keynesian approaches in policymaking were no longer working, Australia's policymakers increasingly embraced economic rationalism as a means to improve the situation. In essence, economic rationalism favours less government intervention in the market, as this is thought to be the best way to achieve greater efficiency. The concept of economic rationalism has been described by Whitwell (1993a) as follows:

> For economic rationalists greater efficiency is a sacred goal. Increased competition and the unlocking of market forces are the key means to obtain it. Economic rationalists are highly suspicious of government intervention. They believe that the central aim of policy should be the establishment of a framework in which the efficacy of market forces is maximized and hence where resources can be allocated as efficiently as possible. Policies should therefore concentrate on improving the dissemination of information, improving the mobility of labour and other resources, discouraging restrictive trade practices, and, to state the obvious, trying to encourage as competitive a system as possible (10).

Economic rationalism led to the abandonment of Australia's traditional approach of high protectionism in favour of international free trade policies, as well as microeconomic reforms aimed primarily at increasing industry competition and reducing costs (Bell, 1998). Microeconomic reform included polices of deregulation and privatization. In Australia, microeconomic reform began in earnest in 1973 when the federal government made a 25 per cent cut in manufacturing tariffs. Just as the introduction of manufacturing tariffs had helped justify formal agricultural assistance in the 1920s, the general reduction in tariffs in the 1970s and 1980s increased the impetus to reduce agricultural assistance (Productivity Commission, 2000a). Other notable economic reforms during this period included the floating of the Australian dollar in 1983 and subsequent deregulation of the financial system (Quiggen, 1996). As the government continued to withdraw from traditional areas of involvement such as banking, telecommunications, transport, and public utilities, the significant presence of statutory authorities in the grains sector became increasingly incongruous with this overall trend[18] (A.S. Watson, 1999).

One outcome of Australia's policymaking shift towards economic rationalism was the establishment of the Industries Assistance Commission (IAC) in 1974. Since its establishment, the IAC[19] has acted as a public advocate of microeconomic reform in every area of the economy (Quiggen, 1996). The IAC was required to review and report on governmental assistance to all industries, including agriculture. In this regard, the IAC was required to review and report on the wheat sector prior to the re-negotiation between the government and AWF of wheat marketing legislation every five years. Accordingly, the IAC presented reports on the wheat industry in 1978, 1983, and 1988. All three reports recommended greater competition and greater flexibility in wheat marketing arrangements, including deregulation of the domestic market. The IAC's third report also suggested removal of AWB's export monopoly. The IAC's activities brought about a

[18] In this respect, the federal government announced during 1988 that domestic support arrangements for agriculture should be progressively reduced, as this would be consistent with its overall approach at reducing protection and assistance throughout the economy (Whitwell and Sydenham, 1991).
[19] The IAC was joined with two other independent bodies to form the Productivity Commission in 1998. The Productivity Commission is an independent Commonwealth agency, which serves as the government's principal review and advisory body on microeconomic policy and regulation (Productivity Commission).

more public debate about the efficacy of Australia's wheat marketing arrangements than had occurred in the past (Whitwell and Sydenham, 1991).

In addition to the work undertaken by the IAC, various other government committees and commissions were established during this period to evaluate a variety of grain-related issues. The most notable among them was the Royal Commission into Grain, Storage, Handling and Transport (Royal Commission). Organized in 1986 by the federal and state governments as a response to concerns about the costs and efficiency of the existing regulatory system, the Royal Commission was the first comprehensive examination of the national grain handling and transportation network to occur in over fifty years (Wilson and Orr, 1989). A.S. Watson (1999) contends that the work of the Royal Commission represented a turning point in the debate on grain marketing in Australia. The Royal Commission examined the institutional environment, namely the legislative and administrative arrangements of the system, and the effects these arrangements had on incentives for efficiency and cost effectiveness. The Royal Commission concluded in 1988 that the existing system, the central feature of which was the exclusion of significant competition for most of the organizations involved, did not meet its criteria of economic efficiency, cost effectiveness and integration. Among other things, the Royal Commission contended that the system did not encourage grain to move along the least cost path, as movement was typically restricted to a predetermined number of paths. The Royal Commission was particularly critical of cost pooling, in which bulk handlers pooled costs and charged growers an average price. It argued that such practices distorted market signals by not properly reflecting the actual cost of services. Cost pooling resulted in over-utilization of inefficient facilities and underutilization of efficient ones, and substantial income transfers between growers. The Royal Commission recommended a series of deregulatory changes, including removal of the bulk handler's sole receival rights; corporate restructurings to establish commercial operating structures for the bulk handlers, including consideration of removing government ownership; and requiring marketing boards to minimize storage, handling and transport costs and to reflect in its returns to each grower the actual storage, handling, and transport charges incurred by that particular grower (Royal Commission, 1988).

4.2.2 Farmer opinion

Although there was clearly support for domestic deregulation within the government's ranks, many Australian growers remained opposed to reform in the 1980s. Unfortunately, little hard information exists as to what percentage of growers actually favoured deregulation in the late 1980s (Whitwell and Sydenham, 1991). That being said, however, some prominent growers did support change. Martin (1990) asserts that initial opposition to Australia's regulated wheat marketing arrangements arose from within the ranks of grower groups that had traditionally been staunch supporters of the system, most notably the AWF. Among the grower critics were key executives of the AWF, including Trevor Flugge[20], who supported domestic deregulation. In his capacity as AWF president in 1983, Mr. Flugge criticized the statutory domestic storage, handling, and transportation arrangements, claiming they encouraged inefficiencies which led to lower returns to growers.

[20] Mr. Flugge would later serve as AWB chairman from 1995 to 2002.

Although views such as Flugge's were held by some of AWF's executives, they did not necessarily reflect those of AWF's membership overall, and such divisions eventually led to the dismissal of its executive director in 1986 (Whitwell and Sydenham, 1991). Martin (1990) notes that although the heated debates within the grower groups resulted in defeat for those growers who sought reform, their arguments, combined with those put forward by institutions such as the IAC, undoubtedly influenced deregulation. Furthermore, such conflicts within AWF's ranks eroded the organization's ability to provide a clear vision for the future evolution of the industry, and weakened its relationship with the federal government[21].

4.2.3 International factors

In addition to the aforementioned domestic pressures, international pressures have also been recognized as influencing Australia's shift towards deregulation in the 1980s (Ryan, 1994a). Of particular importance was the export subsidy battle between the U.S. and European Commission (EC) and its effect on Australia's competitive position in global markets[22]. Export-dependant nations such as Australia felt the effects of this subsidy war: Asking prices for Australia's major wheat class, ASW, fell by nearly 40 percent during 1986. As a result, the Australian government was required to make a

[21] A pivotal member of the government in bringing forth change was John Kerin, the Minister for Primary Industries and Energy, who was convinced that statutory marketing authorities such as AWB had to become more commercially oriented (Whitwell and Sydenham, 1991). In 1989, Minister Kerin went so far as to publicly chastise the AWF (by then re-named as the GCA), criticizing the organization for "arguing for the status quo" and not seeming to understand that the industry was undergoing continuous change (Kerin, 1989). The Minister's negative comments about the AWF reflected his style when pushing for regulatory reforms. As described by Campbell (1985), reforms to federal marketing bodies such as the AWB encountered considerable grower resistance, "but the Minister tends to ignore the protestations" (221).

[22] Beginning in the mid-1980s, amid burgeoning ending stocks, the U.S. and EC became engaged in a bitter export subsidy battle, the latter using its export restitutions and the former introducing its Export Enhancement Program.

substantial payment of several hundred million dollars to make up for a shortfall in AWB's 1986-87 pool (Wilson and Orr, 1989). Australia's Minister for Primary Industries and Energy referred to the impact of these sorts of international pressures when pushing for deregulatory changes to Australian wheat marketing arrangements in 1989:

> ...Australia cannot compete with the treasuries of the U.S. and EC. We can only respond to difficulties on the world market by ensuring that we not only grow but also handle and market our grain as efficiently as possible. This objective cannot be achieved while unnecessary regulation controls limit the AWB's effectiveness and impose extra costs on growers and users of wheat (Kerin, 1989: 1613).

During the late 1980s, the GATT Uruguay Round of negotiations was also underway, and export-dependant countries such as Australia were hopeful that negotiations could lead to some degree of discipline on subsidies, and that an agreement would be beneficial for Australian grain growers in terms of improved market access and prices (Ryan, 1994a). If this occurred, then a general belief was that countries with the most efficient production and marketing systems would have a fairer chance of gaining a competitive advantage in global markets.

4.3 Deregulatory changes to Australia's industry arrangements, 1989

The culmination of the aforementioned pressures for change was the passage of deregulatory legislation in 1989. After some of the most controversial debates on the subject of wheat marketing to occur in fifty years in Australia, some of the most significant changes ever made to the regulatory system of wheat marketing and handling occurred with the passage of the *Wheat Marketing Act 1989* (Ireland, 1998). During the proposed legislation's reading in Parliament, the Minister for Primary Industries and Energy stated that there was no longer any justification for continuing AWB's domestic monopoly. Moreover, he criticized the AWB's guaranteed minimum price formula as being a poor indicator of market returns to growers, and indicated that the proposed legislation would extend the AWB's commercial powers and flexibility to ensure it would be able to compete effectively in a deregulated market. However, in response to "widespread concerns expressed by the GCA and growers generally", the minister indicated that the AWB would retain its single desk status for exports (Kerin, 1989). Table 4.2 summarizes the major changes implemented by the 1989 legislation.

Table 4.2 Major changes introduced by the *Wheat Marketing Act 1989*

- Deregulated the domestic wheat market by removing AWB's compulsory acquisition powers and administered domestic pricing arrangements.
- Replaced the guaranteed minimum price to growers with a declining government guarantee on AWB borrowings for pooled wheat.
- Established the Wheat Industry Fund, a future capital base for the AWB funded by a mandatory two per cent grower levy on wheat.
- Specified AWB's objective as maximizing returns to growers by minimizing storage, handling, and transport costs, with costs to be passed back to individual growers wherever possible (i.e. no cost pooling).
- Permitted AWB to trade in grains other than wheat.
- Permitted AWB to buy, establish, own and operate facilities for handling, loading and unloading wheat or other grains.
- Continued the wheat marketing legislation indefinitely by removing the 5-year sunset clause.
- Allowed AWB to have more than one receiver of grain in a state.

Further amendments made in 1992:

- AWB allowed to engage in value-added activities such as milling.
- Government guarantee on AWB borrowings scheduled to cease June 30, 1999.

Sources: Ireland (1998); Ryan (1994b)

Overall, the passage of the *Wheat Marketing Act 1989* represented a move away from regulation of the Australian grains sector, creating an impetus for statutory organizations to become more commercially responsible and responsive (Ryan, 1994a).

Foremost among the legislative changes was the deregulation of the domestic wheat market: Effective July 1, 1989, AWB ceased to be the sole marketer of wheat sold domestically. In addition, the bulk handlers lost their exclusive wheat handling rights, as AWB was allowed to have more than one receiver of grain in a state, thereby putting competitive pressures on these organizations. AWB was explicitly required to maximize net returns to growers, which included the requirement to minimize storage, handling and transport costs. In this respect, these costs were no longer to be pooled but instead passed back to growers based on their individual transactions, where possible.

The 1989 legislation expanded AWB's potential range of activities by allowing the organization to trade in grains other than wheat, as well as trading in grains produced overseas. As well, AWB's powers were expanded to allow it to buy, establish, own and operate grain handling facilities. As a result of legislative amendments made in 1992, AWB was also given the authority to engage in value-added activities (for example, flour milling) to complement its trading activities. The 1989 legislation also removed AWB's system of government-guaranteed minimum prices to growers, replacing it with an overall fixed government guarantee on AWB borrowings related to pooled wheat. As a result of these changes, the Australian government no longer provided a direct income guarantee on grower returns[23].

Because the government's borrowing guarantee was scheduled to decline and eventually end by 1994 (legislative amendments in 1992 extended the guarantee to 1999), and because the guarantee did not apply to AWB's deregulated domestic trading or investment activities, the 1989 legislation enabled AWB to establish a compulsory

[23] As Ryan (1994b) notes, the significance of this change became apparent in November 1990, when world wheat prices collapsed and therefore so did AWB pool return estimates (including advance harvest payments to growers). Government underwriting of AWB borrowings did not provide a price floor to growers like the former guaranteed minimum price arrangements would have.

grower-funded capital base, known as the Wheat Industry Fund (WIF). Prior to this period, AWB had not been permitted to build up capital reserves of any significance, primarily because it had no need for such reserves: government financing arrangements supported the AWB's marketing activities, and the organization did not require significant capital outlays for infrastructure such as that required by the bulk handlers. The inclusion of the WIF provision in the 1989 legislation was a result of lobbying efforts by the GCA and the AWB, as they believed the AWB could not operate successfully in a deregulated market without significant operating capital (Ryan, 1994b). The GCA's executive director has described the decision to establish the WIF as follows:

> Quite simply, without a capital base the [AWB] could not continue to function effectively and would undoubtedly lose the confidence of the growers whom it was established to serve, and the Federal Parliament, which grants the AWB its statutory powers. The GCA decided that it was preferable to establish a capital base for the AWB which would provide a clear and unequivocal line of equity to grower equity holders and a facility to receive returns on monies invested (Hooke, 1994: 60).

The WIF was funded through a minimum two percent grower levy on the farm gate value of all wheat sales. The WIF had three main roles: to underwrite AWB's domestic trading operations; to provide a capital base which could be used by AWB to diversify its business activities beyond its traditional role of grain marketing; and to provide a future capital base that would enable AWB to continue to make advance pool payments to growers once government underwriting ceased in 1999[24] (AWB, 1995). All profits from these activities belonged to the WIF. In 1992-93, an agreement was reached to build the WIF up to a level between $450 and $500 million by the year 2000 (AWB, 1994).

[24] Given its size in terms of wheat volumes and its system of advance pool payments to growers at harvest, AWB's borrowing needs were substantial. In the 1980s, after AWB was given the ability to borrow from commercial sources rather than Australia's central bank, it quickly became the largest borrower on the Australian short-term money market and one of the five largest short-term borrowers in the world in offshore financial markets (Whitwell and Sydenham, 1991).

Each year, individual growers received a certificate of equity that indicated their contributions to the WIF, plus their individual share of earnings generated by WIF investments, including profits made by AWB's domestic trading division. Although growers could transfer these certificates to anyone, accessing WIF equity was rather limited during the period 1989 to 1999, as AWB only allowed a limited opportunity for growers to 'buy back' a portion of their equity each year[25]. Growers who left the industry were eligible for a full cashout of their equity. Ryan (1994a) notes that the WIF's clearly-defined grower ownership certificates made it unique among the capital reserves held by Australia's grower organizations during this time period.

4.4 Ongoing deregulatory influences

Although major changes to Australia's regulatory marketing and handling arrangements occurred in 1989, further changes, particularly in terms of state single desk marketing arrangements in various grains and oilseeds, have been made since then. Moreover, pressures for further regulatory reforms remain in 2004, most notably pressures to remove or reform the export single desk for bulk Australian wheat. These pressures not only create uncertainty about the future operating environment of the Australian industry, but also affect the relationships that currently exist among the industry's organizations and growers. Given the effect these pressures have on the organizations examined in this thesis, they are described here. Table 4.3 provides a summary of the major deregulatory pressures that exist in 2004.

[25] For example, in 1994-95, $8.4 million out of a total of $260 million held in the WIF was offered through a buy back program to growers (AWB, 1995).

Table 4.3 Current pressures for further deregulation

National Competition Policy (NCP)	• Australia's federal and state governments have committed to reform legislation that unnecessarily restricts competition; • The current wheat export single desk arrangements do not meet NCP guidelines: A 2001 NCP review concluded the single desk does not provide a net public benefit to Australia. The wheat export single desk will be reviewed again in 2010. • NCP pressure on South Australia to reform its export barley single desk.
Increasing industry tensions in current regulatory arrangements	• Concerns about the relationship between AWB Limited and its single desk subsidiary AWBI; growers and other industry players question whether conflicts of interest necessarily arise between the organization's need to maximize single desk returns to growers and its need to satisfy shareholders • Other industry players, in particular the traditional bulk handlers, want greater contestability in services provided to the export single desk; they contend AWB Limited has an unfair competitive advantage because of its single desk privileges • Concerns that the Wheat Export Authority is not an effective regulator of the export single desk arrangements
Scheduled 2004 review of AWBI	• As required by the *Wheat Marketing Act 1989*, an independent panel will review AWBI's performance as the commercial manager of the wheat export single desk in 2004. • Industry stakeholders are anticipated to use the review as an opportunity to seek changes to AWB Limited's role in the current export single desk arrangements
Ongoing international pressures	• WTO members, most notably the U.S. and EU, are pressing for further reforms to state trading enterprises in the current round of negotiations. The final outcome of the negotiations may affect Australia's export single desk arrangements.

4.4.1 National Competition Policy

Consistent with the 'economic rationalism' approach in policymaking, in 1995 Australia's federal, state, and territorial governments agreed to a comprehensive package of reforms known as National Competition Policy (NCP) to enhance competition in Australia. Under the terms of the NCP, legislation should not restrict competition unless the restriction is deemed to be in the public interest: That is, unless the benefits of the restriction to the Australian community outweigh the costs, and the objectives of the legislation can only be achieved by restricting competition, then the legislation should be reformed. As part of their NCP commitments, federal and state governments undertook to review and, where appropriate, reform all legislation existing as of June 1996 that restricted competition. Over 1,700 pieces of legislation were identified for review (NCC, 2003a). Included among these were various federal and state legislation involving statutory marketing arrangements for wheat, coarse grains and oilseeds. Various reforms to grain marketing legislation have been made since 1989, and further reforms are scheduled to occur. Table 4.4 indicates grain-related legislation subject to NCP review and the corresponding legislative status as of 2003.

As Table 4.4 indicates, in addition to the export single desk for bulk Australian wheat, in 2003 several states—New South Wales, Western Australia, and South Australia—had single desk marketing legislation for various grains. However, New South Wales is scheduled to remove its single desk rights in September 2005[26]. Western Australia has made the removal of its export single desk arrangements for the state's canola, barley and lupins contingent on removal of Australia's wheat export single desk[27] (NCC, 2002). In South Australia, an NCP review of the state's export single desk arrangements for barley concluded in 2003 that the single desk did not meet the public benefits test[28]. After consulting with the industry, the South Australian government is expected to introduce a draft bill with proposed changes sometime in 2004.

[26] The NSW Grains Board collapsed due to insolvency in 2000. Grainco Australia consequently purchased its exclusive rights for export barley, canola, sorghum, and domestic barley, which will expire on September 30, 2005. These rights are now held by GrainCorp, which merged with Grainco Australia in 2003. New South Wales removed all restrictions on the marketing of sunflower, safflower, linseed, soybeans, as well as domestic marketing of feed barley, canola and sorghum in 2001 (NCC, 2002).
[27] The state government's rationale for doing so is its suggestion that its single desk (operated by a subsidiary of CBH) would lose substantial market share to AWB Limited if the former's single desk rights are removed while AWB Limited's export rights remain (NCC, 2002).
[28] The NCP panel recommended 'controlled deregulation' by establishing an export licensing authority similar to the one recently established in Western Australia, which grants a main export license to the state's current single desk holder but also has the authority to grant licenses to other marketers if such exports would not threaten the premiums earned by the single desk (NCC, 2003b).

Table 4.4 Grains subject to marketing restrictions prior to NCP review and reform, and legislation's status in 2003

Jurisdiction	Legislation identified for NCP Review	Organization involved	Domestic competition restrictions	Export competition restrictions	Legislation's status in 2003
Commonwealth	*Wheat Marketing Act 1989*	Australian Wheat Board (now AWB Limited)		Wheat	Remaining, but does not comply with NCP principles; subject to NCP review again in 2010
New South Wales	*Grain Marketing Act 1991*	NSW Grains Board (export rights now held by GrainCorp)	Barley Sorghum Oats Canola Safflower Sunflower Linseed Soybeans	Barley Sorghum Oats Canola Safflower Sunflower Linseed Soybeans	Domestic malting barley and export barley, sorghum and canola restrictions remain, but are scheduled for removal in September 2005
Victoria	*Barley Marketing Act 1993*	Australian Barley Board	Barley	Barley	Removed
Queensland	*Grain Industry (Restructuring) Act 1993*	Grainco Australia Limited	Barley Sorghum	Barley Sorghum	Removed
Western Australia	*Grain Marketing Act 1975*	Grain Pool of Western Australia (now Grain Pool Pty, subsidiary of Co-operative Bulk Handling)		Barley Canola Lupins	Remaining, but removal of legislation has been made contingent on removal of Commonwealth wheat export single desk
South Australia	*Barley Marketing Act 1993*	Australian Barley Board (now ABB Grain)	Barley Oats	Barley Oats	Export barley restrictions remain, but under review in 2004

Adapted from NCC, 2002

The NCP-related reforms that have been made, as well as the single desk arrangements that remain, affect the competitive business environment of the five organizations examined as case studies in this thesis. Of particular importance to these organizations is the continuing existence of the export single desk for Australian wheat.

4.4.1.1 NCP review of the *Wheat Marketing Act 1989*

The most prominent grain-related NCP review occurred in 2000, when Australia's wheat export single desk arrangements were examined. The outcome of that review, as well as another scheduled NCP review of these arrangements in 2010, highlights the uncertainty that surrounds the future of Australia's wheat export single desk.

After receiving over 3,000 submissions from stakeholders and consulting widely in both Australia and overseas, in 2000 the NCP review committee concluded that it could not find clear, credible and unambiguous evidence that the wheat export single desk provided a net benefit to Australian wheat growers or to the Australian community. In other words, the *Wheat Marketing Act 1989* did not meet the NCP public benefit test for retaining restrictions on competition. In its report to the federal government, the committee stated: "On balance, the Committee has come to the view that the introduction of more competition into export wheat marketing would have a greater chance in the future of delivering benefits to growers and the wider community in the future than a continuation of the current arrangements" (Irving et al, 2000: 144). Moreover, the committee found that the government had not met certain NCP obligations in relation to the privatization of AWB. Among other things, the government had not demonstrated that it had reviewed matters such as the appropriateness of granting a monopoly to a private company (i.e. AWB Limited).

Although the committee found that Australia's wheat export arrangements did not meet the public benefit test, it acknowledged that analyzing the net benefits of the legislation was a complex task that involved a great deal of uncertainty. Moreover, only a limited period of time had passed since AWB's privatization in 1999, and therefore analyzing the effects of the privatized arrangements was somewhat premature. As a result, the committee recommended that the single desk should be retained until 2004, at which time a review (as stipulated in the *Wheat Marketing Act 1989*) of AWBI's performance in managing the single desk was scheduled to take place. The committee recommended changing the purpose of the 2004 review to conform to NCP principles so that it provides "one final opportunity for a compelling case to be compiled that the 'single desk' delivers a net benefit to the Australian community" (Irving et al, 2000: 8). If no such case could be made by then, the committee recommended that the export single desk should be discontinued.

The federal government responded to the NCP review committee's recommendations in 2001, stating that it would retain the single desk. Furthermore, it would not accept the committee's recommendation to transform the scheduled 2004 review to include NCP guidelines, arguing that this was necessary in order to avoid further uncertainty in the industry about the future of the single desk[29] (NCC, 2002). Although it did agree to improve the Wheat Export Authority (WEA) export consent system[30] by adopting the export licensing arrangements proposed by the committee, the government noted that "radical and destabilising change at this time would not be in the industry's best interests" (Truss, 2001).

[29] In addition, the government stated that it did not want to make amendments to the *Wheat Marketing Act 1989*, as this might have adversely affected AWB Limited's then-current proposal to list equity on the Australian Stock Exchange.

[30] Under the terms of the *Wheat Marketing Act 1989*, the WEA controls the export of wheat from Australia. AWBI has special wheat exporting privileges. All other potential exporters must apply for written consent from the WEA. For applications to export wheat in bulk, the WEA must consult with and receive written agreement from AWBI before granting an export license. For applications to export wheat in containers or bags, the WEA need only consult with AWBI before granting a license.

The government's reluctance to implement the more controversial recommendations of the 2001 NCP review has largely been attributed to political reasons: This time period coincided with a federal election year, one in which rural ridings were particularly important to the incumbent government. In this political environment, any move to implement controversial changes to an export single desk system that had the support of most Australian wheat growers would have been politically risky (Australian Financial Review, 2001). As mentioned, the wheat export legislation is scheduled for another formal NCP review in 2010.

4.4.2 Increasing industry tensions

In the late 1990s, government policymakers were aware of the significant changes that competition reforms would have on the grains industry, and the possible tensions among industry stakeholders that could arise as a result. The importance of the next several years in shaping the future of the industry, as well as the related problems that could arise during this period, were explicitly stated in 1999:

> It is generally accepted that there will be, over time, some rationalisation among former statutory grain marketers and handlers. The commercial and investment decisions made over the next couple of years by growers, handlers, marketers and investors will have important long term consequences for them individually and for the industry as a whole. The [National Competition] Council[31] is also aware of concerns that the export monopoly may advantage AWB Ltd's position in domestic marketing and handling markets and, hence, disadvantage other players in these markets (NCC, 1999: 145).

Rationalization of the industry has indeed occurred. Moreover, tensions among the industry's remaining stakeholders regarding the existing regulatory arrangements, in particular the wheat export single desk, have intensified in recent years. Although the

[31] The National Competition Council (NCC) is a federal statutory authority, established in 1995 to function as an independent advisory body for all Australian governments on the implementation of NCP reforms (NCC, 2002).

majority of growers remain supportive of the concept of an export single desk for Australian wheat, in recent years there has been increasing criticism about how the single desk arrangements have been carried out since AWB was privatized in 1999. At the heart of these criticisms is the role of AWB Limited, now a shareholder-owned company, and its relationship with its wholly-owned subsidiary, AWBI, which has formal responsibility for the single desk. Some industry stakeholders have questioned whether there are inherent conflicts in having a for-profit commercial entity such as AWB Limited manage the single desk (through its subsidiary AWBI) on behalf of Australian growers. In this respect, critics question whether the organization can simultaneously maximize grower returns from the single desk and satisfy the investment expectations of shareholders.

Criticism about the current industry and regulatory arrangements has been strongest from the traditional bulk handlers (GrainCorp, AusBulk, and CBH) who are now diversifying their own operations and competing with AWB Limited in various business segments. These entities find themselves in an awkward position, as AWB Limited is simultaneously their major customer (because of its role as the single desk wheat exporter) and a direct competitor in activities such as storage and handling and financial lending to growers. The traditional bulk handlers resent the powers retained by AWB Limited in managing export wheat along the supply chain, including the power to set grain receival standards, negotiate freight rates, and capture revenues from blending activities. They are particularly upset with AWB Limited's entry as a direct competitor in the storage and handling sector, as this has eroded the healthy margins previously enjoyed in their traditional geographic markets (Wise, 2003; Bolt, 2002d). Moreover, these organizations are concerned that AWB Limited may be able to use its single desk export privileges to gain an unfair competitive advantage in activities such as seed breeding, domestic grain trading, and storage and handling (Bolt, 2003a).

The traditional bulk handlers have been publicly critical of AWB Limited and the single desk arrangements. For example, two of the bulk handlers released reports in 2002[32] that examined the single desk arrangements, in particular AWB Limited's role in managing export wheat as it moves along the supply chain from farm to port. Both reports raised serious concerns about the suitability of AWB Limited's role in managing the single desk, and claimed that costs to growers would be reduced if greater contestability for services related to managing export wheat were allowed. Another bulk handler, CBH, expressed similar criticisms when it made an aggressive proposal in 2002 to take over export pool management services free of charge from AWB Limited in Western Australia[33]. In essence, the traditional bulk handlers are advocating for changes that would lessen AWB Limited's role in managing export wheat along the supply chain, which would move the export single desk to a free on board position.

Industry tensions regarding the role of AWB Limited and the wheat export single desk were more recently demonstrated during a 2003 senate inquiry into proposed amendments to wheat marketing legislation[34], the main purpose of which was to establish future funding sources for the WEA's operations. During the public inquiry process, industry stakeholders including individual growers, grower groups, and the traditional

[32] The reports were commissioned by Grain Growers Association and United Grower Holdings, the holding companies of GrainCorp and AusBulk, respectively. The reports were prepared by consultants Accenture (2002) and Kronos Corporate (2002), respectively.
[33] This proposal is described in CBH's case study, presented in chapter six.
[34] The proposed legislation was the Wheat Marketing Amendment Bill 2002.

bulk handlers voiced their concerns about the effectiveness and fairness of the current single desk arrangements. The inquiry turned into a much broader debate about several issues, including the WEA's effectiveness as a regulator and its ability to monitor AWB Limited's single desk activities; conflict of interest concerns about AWB Limited's responsibilities to both growers and shareholders; and concerns about the potential for AWB Limited to use the powers associated with the single desk to unfairly advance its business interests in other sectors such as storage and handling. The inquiry showcased concerns about the relationship between AWB Limited and AWBI, and the related lack of transparency and accountability to growers regarding the single desk. After concluding its inquiry, the senate committee described current industry sentiments as follows:

> ...the Committee has heard a great deal of compelling evidence...that growers and industry participants have developed an understandable degree of unease and scepticism as to the functioning of the oversight role that has developed in the last 5 years between the WEA, AWBI and AWBL which, in the Committee's view, directly affects the viability and credibility of the benefits and effectiveness of the single desk export mechanism and the implications for maximizing grower benefits (Senate Rural and Regional Affairs and Transport Legislation Committee, 2003: 30).

In response to the senate inquiry's report, the government agreed to accept amendments[35] to strengthen the powers of the WEA necessary to perform its regulatory functions. However, contrary to the wishes expressed by several stakeholders, the government reiterated that the purpose of the 2004 review of AWBI is to assess its performance in managing the export single desk, and that the review will not address the issue of the existence of the single desk itself[36] (Truss, 2003a). Although the government's 2003 amendments represented efforts to appease industry tensions about the single desk arrangements and AWB Limited's role, it is anticipated that the scheduled

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[35] These amendments were included in the *Wheat Marketing Amendment Act 2003, an Act to amend the Wheat Marketing Act 1989, and for related purposes*, assented to July 22, 2003.
[36] The government also re-iterated that NCP principles would not be incorporated into the 2004 review.

2004 review of AWBI will serve as another forum in which industry stakeholders express their grievances and advocate for reforms.

4.4.3 Review of AWB (International) Limited in 2004

As part of the process to privatize the AWB in 1999, the federal government agreed that a review of AWBI's performance in managing the export single desk would be conducted by the end of 2004. The stated purpose of the review is to assess AWBI's performance as the commercial manager of the export single desk and its obligation to maximize net returns to growers. The review will also evaluate the effectiveness of the WEA as the single desk regulator[37] (Truss, 2003b). As mentioned, it is most likely that the 2004 review will serve as another forum in which industry stakeholders, including growers and the former statutory bulk handlers, express their concerns about the current industry arrangements[38].

4.4.4 Continuing international pressures

As well as ongoing domestic pressures for change, international pressures also exist, most notably multilateral trade negotiations at the World Trade Organization (WTO). During the current round of WTO agriculture negotiations, one topic that is receiving attention is reform of state trading enterprises (STEs). Given the exclusive export marketing rights granted to it by the Australian government, AWB Limited is considered to be an STE. Several WTO members, most notably the U.S. and EU, are

[37] The review's report is to be publicly available by September 1, 2004.

[38] As one industry observer describes it, as a result of the scheduled review, 2004 will be a year of "unprecedented brawling" as industry stakeholders voice their opinions on the current arrangements, particularly AWB Limited's role and powers in the system (Bolt, 2004).

advocating for reforms that would further discipline, or eliminate altogether, exclusive rights of STEs. If such reforms are incorporated into any future multilateral agreement to which Australia is a signatory, the country's existing regulatory arrangements in grain marketing could be affected, most significantly the wheat export single desk. If this occurs, then Australia's current industry arrangements would be significantly altered as organizations attempt to gain a foothold in the export marketing of Australian wheat, a function that was previously the exclusive domain of AWB Limited. In this respect, new competitors would include not only the Australian entities examined in this thesis but also multinationals seeking a greater presence in marketing Australian grain.

4.5 Summary

A confluence of factors led to deregulatory changes to Australia's grain marketing and handling arrangements beginning in 1989. These legislative reforms marked the beginning of an era of significant changes to Australia's traditional marketing and handling organizations. Although significant changes have occurred, pressures for further industry reforms remain in 2004. These factors are affecting industry relations among the Australian organizations and growers, and the possibility for changes to the export single desk arrangements in the not too distant future remains strong. Any such changes would ultimately impact the operating environment of the Australian grains industry, including the organizations that are examined in this thesis.

Chapter 5 New institutional economics and cooperative life cycle theory

5.1 Introduction

The preceding chapters have described the statutory marketing and handling arrangements that presided until deregulatory changes began in 1989, as well as pressures for further industry reforms that remain in 2004. The main organizations involved in Australia's statutory system were modeled like traditional agricultural cooperatives, in which growers collectively marketed and handled their commodities, with the backing of government-granted privileges. The cooperative nature of these organizations provides an opportunity to evaluate their evolution using theory that considers the distinctive features of cooperatives relative to other forms of organization. During the past few decades, significant structural changes have increasingly occurred among traditional agricultural cooperatives in various countries. Several researchers have sought a greater understanding of why these changes are occurring, and have utilized new institutional economics for this purpose. From this perspective, researchers contend there may be inherent weaknesses in the traditional cooperative structure that make this organizational form unattractive as its environment changes; for example, when external forces such as industrialization and globalization significantly alter the broader industry environment in which the cooperative operates. A leading contributor of research in this area is Dr. Michael Cook, who has developed a life cycle theory to help understand cooperative organizational change.

The purpose of this chapter is to identify the distinguishing features of cooperatives relative to other forms of organization and to summarize research that has been done in the field of new institutional economics regarding cooperative organizational change, in particular cooperative life cycle theory. In a later chapter, cooperative life cycle theory will be applied to the Australian experience, in order to examine whether the evolution of Australia's major marketing and handling organizations and their underlying reasons for change are similar to those suggested by the theory.

5.2 Differences between cooperatives and investor-oriented firms

In order to understand the challenges agricultural cooperatives have faced over the past several decades in terms of strategic choices and organizational structure, it is first necessary to understand the fundamental differences between cooperatives and other forms of organization. The main difference lies in the primary role of the user of the business—the grower—in cooperatives, compared to the primary role of the non-user investor in most other forms of organization. For this reason, forms of organization other than cooperatives are referred to in this thesis as investor-oriented firms (IOFs). For the purposes of this thesis, an IOF is assumed to be a share capital corporation whose stock is traded on a liquid secondary market such as a public stock exchange. In a cooperative, ownership and control of the business are based on use, or patronage, of the business. In contrast, ownership and control of an IOF are based on the relative level of individual capital investment in the business. Given these differences, a cooperative is generally defined as a user-owned and user-controlled business that distributes benefits on the basis of use (Barton, 1989)[39]. Viewed from a new institutional economics perspective,

[39] Many cooperative researchers (for example, LeVay, 1983; Staatz, 1987) have pointed out that, given their diversity in terms of actual practices and organization, it is virtually impossible to devise a concise definition that encompasses all cooperatives. Nevertheless, the three basic concepts of user-control, user-

cooperatives differ from IOFs in terms of their property rights structures, in that the former typically allocate residual claims and residual control rights based on use rather than investment.

5.2.1 The concept of ownership: Residual claims and residual control rights

The more general economic concept of ownership must be clarified if one is to fully understand the user-oriented principles that differentiate cooperatives from IOFs. Economic analysis of ownership and its associated property rights[40] involves two primary issues: the allocation of residual control rights and the allocation of residual claims. Residual control rights are defined as the right to make any decisions concerning an asset's use that are not explicitly controlled by law or assigned to another party by contract. Residual claims represent the right to an asset's net income; that is, the rights to any monies remaining after the firm has paid all of its contracted costs (which includes cost of goods sold, salaries, interest payments, etc). Stated differently, residual claims represent the right to the amount left over after everyone else has been paid (Milgrom and Roberts, 1992). The concept of residual claims is intimately tied to the concept of residual risk, which represents the risk of a difference between a firm's stochastic inflows (i.e. its revenues) and promised payments to agents (i.e. its costs). Residual risk is typically borne by those who contract for the rights to the firm's net cash flows, namely, the residual claimants (Fama and Jensen, 1983a). The varying characteristics of residual claims and residual control rights distinguish organizations from one another. In this

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ownership, and user-benefits are frequently used to describe the distinguishing features of cooperative organizations relative to IOFs.

[40] Cook and Tong (1997) define property rights as "a socially and legally enforced right to select uses of an economic good. Practically speaking, property rights give owners claim to the residual returns of the firm and a part in the decision process" (114).

manner, the arrangements of residual claims and residual control rights in a cooperative distinguish this form of organization from an IOF. Table 5.1 outlines the main differences, which are further explained in the following sections.

Table 5.1 Distinguishing features of traditional cooperatives versus IOFs

	Traditional cooperative *Key features:* *User-controlled* *User-owned* *Benefits distributed on the basis of use*	**IOF** *Key features:* *Investor-controlled* *Investor-owned* *Benefits distributed on the basis of investment*
Residual claims (the right to a firm's net income)	Held by cooperative members, who are users of the business. Allocated according to the member's level of *use* of the business. Not typically transferable to other members or non-members. Equity does not appreciate/depreciate in value.	Held by investors (usually through shares which entitle the holder to dividends) who are not typically users of the business. Allocated according to the individual's level of capital *investment* in the business. Typically transferable to other investors through a secondary market (such as a stock exchange). Equity can appreciate or depreciate in value.
Source of equity	Members and retained earnings	Investors and retained earnings
Residual control rights (exercised through voting rights and the organization's governance structure)	Held by members. Voting rights are typically on the democratic basis of one vote per member, although in some cases voting may be in proportion to the member's level of use of the business.	Held by investors. Voting rights are allocated in proportion to the level of investment in the business, e.g. one vote per share.

5.2.2 Residual claims: The cooperative principles of user-ownership and user-benefits

The cooperative principle of user-ownership implies that the persons who use the cooperative's products and services are the same persons who own and finance the business. These persons are referred to as the cooperative's members. In a traditional agricultural marketing cooperative, farmers who deliver commodities to the organization are essentially the owners of the firm. Not only do these farmers provide the physical product to be marketed by the organization, but they may also provide the capital needed to finance its operations. A cooperative typically accumulates capital from its members through various methods, which may include requiring a direct investment from its members, but more commonly by implementing an arrangement in which the cooperative retains a certain proportion of earnings generated within the organization rather than distributing it to members in the form of patronage refunds. Equity retained within the cooperative in this manner is usually redeemable to its members at a future date. The cooperative's governing board of directors decides on the organization's equity redemption policy[41]. Equity redeemed by a cooperative is usually done so at book value. As such, cooperative equity does not have the ability to appreciate in value in the manner that IOF tradable equity is capable of. As well, cooperative equity is typically not transferable, as members are not allowed to sell their equity to another person. In contrast, an equity holder in an IOF may usually sell his shares to another party (Cobia and Brewer, 1989).

The cooperative principle of user-benefits implies that benefits generated by the cooperative's activities accrue to members according to their level of use of the business, rather than their level of capital investment. In this capacity, the cooperative's users – its members – are the residual claimants to the net income generated by the organization. IOFs, on the other hand, distribute benefits to investors according to the relative level of

[41] Popular redemption plans include special situation plans, in which redemption is initiated by a special situation of a member such as moving away; and the revolving fund plan, in which a cooperative pays off in cash the oldest equities on a first-in, first-out basis. The average revolving period tends to be about 10 years (Cobia et al, 1989).

equity invested (i.e. the number of shares held), so that the organization's providers of capital are its residual claimants (Fulton, 1995). IOF investors provide capital to the organization and in turn receive shares which entitle the holder with rights to participate in the organization's net earnings (in the form of dividends). Fama and Jensen (1983a) point out that the least restricted residual claims typically in use are those found in common shares of large IOFs:

> The residual claims of different organizational forms contain different restrictions. For example, the least restricted residual claims in common use are the common stocks of large corporations. Stockholders are not required to have any role in the organization; their residual claims are alienable without restriction; and, because of these provisions, the residual claims allow unrestricted risk sharing among stockholders (Fama and Jensen, 1983a: 303).

In contrast, an agricultural cooperative's residual claims are restricted to the organization's members, and cannot be acquired or relinquished in separate purchase or sale transactions (Vitaliano, 1983).

5.2.3 Residual control rights: The cooperative principle of user-control

The user-control feature of a cooperative implies that the firm's users control the organization. Control of an organization is generally exerted through voting rights, namely the ability to vote on major organizational policies and to elect the board of directors (or some similar form of governance arrangement), who have the power to direct the organization's management in running the affairs of the business[42]. In a cooperative, members are granted these voting and governance rights, and as such possess

[42] As Fama and Jensen (1983a) explain, internal control of an organization is delegated by the residual claimants to a board of directors. Residual claimants generally retain approval rights (by vote) on matters such as board membership and major firm actions such as the decision to merge with another entity. Other management and control functions are delegated by the residual claimants to the board, who in turn delegate decision management functions to internal agents (i.e. the firm's management). However, the board retains ultimate control over these internal agents, mainly through its ability to approve and monitor major policy initiatives, and to hire, fire, and set the compensation of the firm's management team.

the organization's residual control rights. Many cooperatives have a democratic voting system, in which each member only has one vote, regardless of the level of business he conducts with the organization. A democratic voting system helps the cooperative serve the common needs of its members rather than the individual need, and this system is a way to ensure that people, not capital, control the organization (Ernst & Young, 2002). In some cooperatives, voting is proportional to the member's level of use of the business. Even in this arrangement, voting power is not based on the level of equity invested in the cooperative. In contrast, in an IOF investors control the organization through voting rights that are granted in proportion to the level of capital invested. In this manner, investors possess the IOF's residual control rights. Given that voting is proportional to the level of investment, an increase in an individual investor's capital holdings is accompanied by a similar increase in voting power.

In light of the differences in residual control rights and residual claims that characterize a cooperative relative to an IOF, Vitaliano (1983) has provided the following definition of a cooperative, which is useful in understanding the integrated role of the grower as user, owner, and controlling stakeholder in a cooperative organization:

> A cooperative can be defined as an economic organization whose residual claims are restricted to the agent group that supplies patronage under the organization's nexus of contracts (i.e., the member-patrons) and whose board of directors is elected by this same group. Such restrictions are imposed to control decisions that would benefit an organization's residual claimants at the expense of its patrons, were the two agent groups distinct, and will be observed to occur when the problems these restrictions themselves create are not prohibitive (Vitaliano, 1983: 1079).

Stated differently, a cooperative is structured in a manner designed to ensure the organization is run primarily for the benefit of the people who use the business, rather than non-user investors.

5.2.4 The grower's role in a cooperative versus an IOF

Given the user-oriented design of a cooperative's residual claims and residual control rights, a grower has multiple roles in a cooperative. In a marketing cooperative, for example, the grower is at once the organization's supplier of product to be marketed, its owner, and its controlling stakeholder. In contrast, an IOF's owners are not required to, and typically do not, have any other involvement with the organization: owners contribute capital to the IOF in exchange for proportional rights to the firm's residual income and organizational control. Other than their ownership interest, these individuals do not usually patronize the organization as suppliers or customers. Furthermore, an IOF's owners may be a diverse and diffuse group of individuals who do not have anything in common with each other (for example, a common occupation such as farming), other than their desire to maximize the return from their investment. The various roles of a grower in a cooperative imply a more complex set of relationships. For example, in an otherwise comparable marketing IOF[43], the relationship with the grower as supplier is a zero-sum game: any increase in payments to the supplier (e.g. for a commodity to be marketed by the firm) is an increase in the firm's cost of goods sold which decreases the residual income available to the IOF's owners. In a cooperative, however, the relationship with its grower-suppliers is not a zero-sum game, as growers are both the organization's suppliers and owners. As such, an increase in payments to the supplier for inputs reduces the organization's residual income, but not necessarily the overall return to that particular grower (Sykuta and Cook, 2001). As will be demonstrated in the remaining sections of this chapter, the complex role of the grower as

[43] This assumes that growers are not among the owners of the IOF.

user, owner, and controlling stakeholder of a cooperative may create challenges for this type of organization that are not present in an otherwise comparable IOF.

5.3 New institutional economics

Several researchers have examined cooperatives in terms of their structure of property rights and the effects these structures have on incentives and organizational behaviour. The work of those who have examined cooperative organizational change from this perspective falls within the realm of new institutional economics (NIE).

NIE is a field of study that encompasses transaction cost economics, agency theory, and property rights analysis, all of which focus on various aspects of firm organization (Royer, 1999). NIE, a phrase coined by Oliver Williamson (Coase, 1998), is an area of study emanating from Coase's 1937 article "The Nature of the Firm". It distinguishes itself from the traditional neoclassical economic paradigm by incorporating the concept of transaction costs[44] into its analysis. Whereas a neoclassical approach focuses on profit-maximizing behaviour of abstract firms, NIE focuses on the nature of the firm itself. A fundamental premise of NIE is that differences in organizational structure can affect the economic outcome of transactions. As such, NIE may provide an insight into the choice of organizational form and the evolution of alternative business structures over time (Royer).

A major concept of NIE is the incomplete nature of contracts and how the resulting allocation of residual control rights and residual claims within a firm affects its overall

[44] Transaction costs are the costs of organizing and transacting exchanges (Royer, 1999).

performance. Contracts specify the rights and obligations of the parties involved in an exchange. A contract is deemed to be complete if it specifies these rights and responsibilities for every conceivable contingency that may arise during the course of the transaction. However, in most organizations, it is virtually impossible to design contracts that anticipate all possible contingencies, the decisions and actions that should be taken in each scenario, and the associated compensation each party should receive. Given the incomplete nature of contracts, a firm's structure of residual control rights and residual claims is important because it affects the behaviour of both owners and management which in turn affects the overall performance of the organization. Jensen and Meckling (1979) recognized the important role of contracting and residual rights in this regard, asserting that a firm's output is dependent not only on factors of production such as technology and knowledge, but also on the contracting and property rights system within which the firm operates.

5.4 New institutional economics applied to cooperatives

Royer (1999) presents a comprehensive overview of NIE and how it has been applied to the study of cooperatives, and concludes that NIE methods of analysis are extremely useful in understanding cooperative organizational strategy. Royer describes the various changes that have been observed in cooperatives as well as agriculture in general during the past several decades. In terms of the latter, Royer notes that agricultural industrialization[45] and globalization have brought about rapid changes to the industry. In

[45] Boehlje (1996) has described the industrialization of agriculture as "the application of modern industrial manufacturing, production, procurement, distribution, and coordination concepts to the food and industrial product chain...the new industrialized agriculture moves toward a) manufacturing processes, b) a systems approach to production and distribution, c) separation and realignment of the stages in the food chain, d)

this altered industry environment, cooperatives have attempted to adapt by undertaking substantial horizontal and vertical restructurings through methods that include not only mergers and acquisitions, but also more fundamental institutional changes such as conversion to IOF structures. Others have formed hybrid structures that integrate some features of IOFs while attempting to maintain a cooperative character, while some have sought external sources of equity capital through mechanisms such as publicly-held subsidiaries or joint ventures with IOFs. Observing these changes, Royer describes why NIE has emerged as a useful approach to understanding cooperative change:

> The increasing frequency with which this institutional reorganization has taken place has led to the perception that there may be fundamental features intrinsic to the cooperative organizational form that restrict cooperatives from being able to compete effectively in an increasingly complex economy and that ultimately threaten their long-term survival. Concurrent with the restructuring of cooperatives, and the economy at large, economists have been developing new methods for analyzing organizational forms and their relationships within the market system (Royer, 1999: 44).

Much of the work applying NIE concepts to cooperatives has focused on potential weaknesses that may be inherent in a traditional cooperative's property rights structure—i.e. the design of its residual claims and residual control rights—relative to that of an IOF. A cooperative's user-oriented property rights result in differences in incentives for owners and management relative to those of an IOF, which may lead to differences in organizational behaviour (Staatz, 1987). Several researchers have suggested that these differences may lead to problems for both the firm and its members. For example, LeVay (1983) suggests that, due to their internal organization, "…cooperatives may have particular problems of participation, management and control not paralleled in conventional firms. They may, as a result, be more or less efficient in terms of market entry, growth, survival and competitiveness" (2). Royer (1999) notes that the existence

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negotiated coordination among those stages, e) new kinds of risk, f) concerns about system power and control, and g) a more important role for information" (30).

of these problems has led some researchers to hypothesize that, although they may initially serve some economic purpose within a market, cooperatives are eventually forced to exit or reorganize as the industry evolves. From this perspective, cooperative life cycle theory has emerged.

5.4.1 Cooperative life cycle theory

Based on their observations of cooperative change in the 1980s and 1990s, both Cook (1995) and Harte (1997) have presented life cycle theories to explain a cooperative's formation, growth, and its eventual decline or restructure. As with Harte[46], Cook's life cycle theory is based on the premise that a cooperative's arrangement of user-oriented property rights can create several challenges for the organization as it evolves. Cook's life cycle theory incorporates many issues that other researchers have noted about cooperative property rights.

Although the models developed by Harte (1997) and Cook (1995) relate to the evolution of agricultural cooperatives, the general concept of using life cycle models to explain different stages of an organization's development and behaviour are not new to the literature on organizational theory (Smith et al, 1985). Biological analogies have been used by economists to develop theories of the firm for many years. Although imperfect, Kimberly (1980) asserts that significant insights may be gained from using such metaphors, as they force researchers to determine where the metaphors are appropriate

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[46] Harte's (1997) life cycle approach to cooperative evolution is based on his observations of the Irish dairy industry and the transformations of its traditional cooperatives into other organizational forms. Harte contends that as market failure problems diminish, the underlying need for cooperatives also diminishes. Furthermore, in a changed market environment other organizational forms will be more efficient than cooperatives because of weaknesses in the latter's structure which lead to higher transaction costs.

and inappropriate, which may stimulate new understandings about organizational behaviour and the changing characteristics of organizations over time.

A life cycle approach to examining cooperative evolution is relatively new but welcomed among cooperative academics. As LeVay (1983) noted in his comprehensive review of cooperative theory, the life cycle of agricultural cooperatives had not received the attention it deserved in past research. LeVay stressed the need for more empirical research to gain greater insight into cooperative genesis, growth, and potential decline. Dr. Cook has greatly contributed to this field of study: In addition to his 1995 article which introduced the life cycle theory, he has furthered his study of cooperative organizational change through work which includes Cook (1997); Cook and Iliopoulos (1998, 1999a, 1999b, 2000); Sykuta and Cook (2001); and Chaddad and Cook (2002, 2003). The relevant contributions of these later works are also described in this chapter. In addition to the work of Cook and his colleagues, various other researchers have undertaken similar NIE studies of cooperative organizational change. In this respect, the work of Fulton and Gibbings (2000) and Trechter et al (2003) have been useful contributions to examining cooperative change in various agriculturally-advanced nations, and their work is therefore described in this chapter.

5.4.2 The cooperative life cycle model

Observing the structural and strategic shifts that were occurring among U.S. agricultural cooperatives in the late 1980s and early 1990s, Cook (1995) developed a five-stage life cycle model to describe a cooperative's genesis, growth, and eventual decline or restructure. At the heart of this framework is the notion that a traditional cooperative's user-oriented property rights structure[47] has inherent weaknesses that create problems for the organization as it evolves. These weaknesses may limit the cooperative's financial flexibility as well as increase costs associated with managing the business relative to other organizational forms. These internal constraints become particularly troublesome for a cooperative when the competitive environment of the industry itself undergoes significant transformation as a result of factors such as the industrialization of agriculture, globalization, government withdrawal of agricultural income and price supports, and technological and demographic changes (Cook and Iliopoulos, 1998). In the past several decades these factors have transformed agriculture into an industry that is increasingly viewed as an integrated system – a value chain – that starts at the seed technology stage and goes all the way to the final consumer of the processed product. Cooperatives, along with other types of organizations, have had to re-evaluate their competitive strategies within this increasingly integrated system.

Changes in agriculture have exposed cooperatives to increased domestic and international competition from other business forms, including IOFs (Chaddad and Cook, 2003). In order to remain competitive, cooperatives have had to adapt to this altered industry environment. In the process of adapting, cooperatives have had to consider whether the traditional organizational structure that served them well in the past is appropriate in light of the strategies they have chosen for the future[48]. As Cook (1997)

[47] In this respect, the key features of a cooperative's property rights structure are: ownership is restricted to users (members); ownership is tied to the members' patronage, and thus ends when patronage ceases; ownership rights cannot be traded, and no secondary market exists to value residual claims; and residual claims are only partly redeemable (through any equity redemption plan the cooperative may have established) (Cook and Illiopoulos, 1998).
[48] In this regard, Cook and Iliopolous (1998) assert that cooperatives are less likely to succeed in a global agri-food system if they do not eliminate or ameliorate the internal organizational inefficiencies associated with their traditional structure of property rights.

describes it, cooperative leaders must ask themselves whether the traditional cooperative form of organization is the most effective in achieving grower objectives in an increasingly industrialized and globalized marketplace. Eventually the cooperative pursues one of several strategic alternatives, which may include exiting by liquidating, merging, or converting into an IOF structure; or continuing in a modified cooperative organizational form whose property rights structure ameliorates some of the former difficulties. An overview of Cook's (1995) life cycle model is presented in Table 5.2.

Table 5.2 Overview of Cook's (1995) 5-stage cooperative life cycle model

Stage One	Stage Two	Stage Three	Stage Four	Stage Five
Cooperative is formed as a response to market failure: Individual producers act collectively to countervail market failure problems. Cooperative strategy is defensive in nature.	Cooperative provides net benefits by marketing products or providing services on more favourable terms than existing IOF oligopolists or oligopsonists	As the cooperative's net benefits become less distinguishable from existing IOFs, focus turns inward to examining transaction costs of cooperative. The organization's vaguely-defined property rights create five main problems: Free rider problem Horizon problem Portfolio problem Control problem Influence costs problem	Managing the cooperative becomes exceedingly challenging, and the cooperative's decision makers consider strategic alternatives: Exit, continue, or transition.	The cooperative's leadership implements preferred alternative: 1) Exit, by liquidating, merging or converting to IOF; 2) Continue but address tendency for under-capitalization by either a) seeking outside equity without restructuring into IOF; or b) pursue proportionality strategy of internally generated capital; 3) Transition into a new generation cooperative. Cooperative strategy becomes more offensive in nature.

Adapted from Cook (1995)

5.4.2.1 Stage one

In stage one of the life cycle, a cooperative is formed as a collective producer response to market failure. In this regard, a cooperative entity represents an institutional mechanism to help individual producers countervail opportunistic behaviour or hold-up situations that arise because of some form of market failure. This rationale for cooperative formation is consistent with the Sapiro and Nourse schools of thought in cooperative theory, which both assert that cooperatives are formed to provide some sort of balancing of market power for producers[49] (Torgerson et al, 1997). Cooperative formation is viewed as defensive in nature, as it is a reaction to help producers overcome existing market failure problems. As Cook (1995) describes it, cooperatives are formed because "depressed prices or market failures create incentives for producers to react collectively" (1155).

5.4.2.2 Stage two

In stage two of the life cycle, the cooperative operates in the market that was previously the domain of oligopolistic IOFs. In this environment, the cooperative is able to provide services or products on more favourable terms than the latter. By doing so, the cooperative is able to provide a net benefit to its members by eliminating or at least improving some of the market failure problems that previously existed. As the IOFs begin to adjust their business practices to align with the competitive behaviour of the cooperative, the cooperative enters stage three of the life cycle.

[49] Two mainstream schools of thought in cooperative theory are commonly attributed to the work of Aaron Sapiro and E.G. Nourse. Sapiro advocated the formation of commodity-wide cooperatives to achieve more orderly marketing of commodities. In this manner, cooperatives could exert market power to reduce imbalances in grower treatment. Nourse, on the other hand, argued that cooperatives should not try to monopolize a market, but should instead add just enough competition to an industry to give farmers a 'competitive yardstick' against which IOF behaviour could be judged (Torgerson et al, 1997).

5.4.2.3 Stage three

In stage three, the previously-oligopolistic IOFs have adjusted their behaviour so that the terms of trade offered to growers by both the cooperative and IOFs are roughly equivalent. As a result, the net benefits provided by the cooperative are no longer as evident as they once were, and growers therefore become more discerning about the organization, scrutinizing its costs more closely. Generally speaking, there is a shift in focus during this stage, from an earlier preoccupation with the external effects a cooperative exerts in terms of confronting the industry's market failure problems, to a concern about the internal aspects of the organization and its efficiency[50]. In this respect, the cooperative's user-oriented property rights structure becomes important, as it may create several problems that hamper the organization's effectiveness over time.

As stated previously, various researchers contend there may be inherent weaknesses associated with a traditional cooperative's structure of property rights. This occurs because a cooperative's user-oriented allocation of residual claims and control rights creates incentive problems in terms of members' willingness to supply capital to the cooperative, as well as their ability to effectively monitor the firm's performance. These problems in turn create difficulties in financing, managing, and governing the organization (Cook, 1997).

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[50] Interestingly, cooperative theory has also evolved in a similar manner, shifting from an early emphasis on the external reasons for cooperative formation to a later focus on internal aspects of cooperative behaviour. As described by Torgerson et al (1997), "In the years since Sapiro and Nourse, emphasis has shifted from concern with the external effects of organization to the internal or micro aspects of organizing and sustaining cooperation" (6).

Cook (1995) identifies five main problems associated with what he describes as a cooperative's "vaguely-defined, 'user versus investor'" set of property rights. These problems, which are summarized in Table 5.3, are referred to as: free rider problem; horizon problem; portfolio problem; control problem; and influence costs problem. In general, the free rider, horizon, and portfolio problems create disincentives for members to contribute capital and invest in the organization's growth. As a result, cooperatives tend to be undercapitalized. The control and influence costs problems tend to increase agency and coordination costs within the organization, thereby creating inefficiencies that can place the cooperative at a disadvantage relative to other industry players who have more effective property rights structures (Cook and Iliopoulos, 1998).

Table 5.3 Vaguely-defined property rights problems of traditional cooperatives

Free rider problem	Horizon problem	Portfolio problem	Control problem	Influence costs problem
Individuals do not bear the full costs of their actions and/or receive the full benefits they helped create. Problem can be both external and internal to the organization	Member's residual claim is shorter than the productive life of cooperative asset. Member is not able to realize the full return on his cooperative investment	Members cannot adjust their cooperative investment to align with their individual risk preferences	Agency costs can be greater in cooperative than IOF because cooperative management is not subject to external monitoring pressures	Individual members attempt to influence management decisions that affect the distribution of benefits among members

Adapted from Cook (1995)

Although they form an integral part of Cook's (1995) life cycle model, these cooperative property rights problems have been identified in some form or another by other academics in earlier works, including Vitaliano (1983); Staatz (1987); and Porter and Scully (1987) [51]. Harte (1997) also refers to the horizon, portfolio, and control

[51] Royer (1999), Harte (1997), and Porter and Scully (1987) point out that the horizon, portfolio, and control problems have also been described by Jensen and Meckling (1979). Although the latter's study

problems in his life cycle examination of Irish dairy cooperatives. Each of the five property rights problems is described below.

5.4.2.3.1 Free rider problem

The free rider problem is perhaps the most widely-recognized challenge associated with traditional cooperative organizations, in particular those that are voluntary (i.e. those having an open membership policy). The free rider problem arises when an organization's property rights are non-tradable, insecure, or unassigned. In a free rider situation, cooperative members or non-members use a resource for their individual benefit; however, property rights are not sufficiently designed or enforced to ensure that these same individuals bear the full costs of their actions or receive the full benefits they helped create.

Cook (1995) notes that two types of free rider problems are possible: external and internal. An external free rider problem occurs when individuals can benefit from the cooperative's actions without actually becoming members of the organization and sharing in any of the organization's costs (Torgerson et al, 1997). In such circumstances, individuals who joined the cooperative bear the full costs but do not capture the full benefits generated by the cooperative's operations. They therefore assume a disproportionate share of the costs relative to the associated benefits created by the cooperative. For example, if the presence of a marketing cooperative in an industry helps generate higher grower returns for a commodity, then an individual grower may be able

primarily focused on labour-managed firms, their analysis is also applicable to cooperative forms of organization.

to take advantage of those higher returns without actually becoming a member (and incurring the associated costs)[52]. This is a form of external free rider problem, as it involves the actions of individuals operating outside of the cooperative's membership. In contrast, an internal free rider problem occurs among a cooperative's membership.

An internal free rider problem occurs when new cooperative members are entitled to the same per unit patronage returns and residual rights as existing members. If no market exists to differentiate the cooperative's residual claims according to the present value of its accrued earnings as well as future earnings potential, then existing members may experience a dilution of their rate of return when new members join. This can create an inter-generational conflict among members, and may lead to disincentives for existing members to invest in the cooperative[53].

In both the internal and external free rider situations, property rights have not been sufficiently designed to ensure that individuals bear the full costs and benefits associated with their actions. In other words, the free rider problem occurs when gains from cooperative action can be accessed by individuals that did not fully invest in developing those gains, whether those individuals are newer members or non-members of the cooperative (Sykuta and Cook, 2001).

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[52] Cook (1995) uses the example of a pear producer who refuses to join a pear bargaining association but nonetheless is able to capture the benefits created from the association's terms of trade in the industry.

[53] Jensen and Meckling (1979) describe a similar 'common-property' problem for labour-managed firms, in which new employees acquire the same claims on cash flows as existing employees. As a result, older workers have to share with newer workers the anticipated cash flows from past investments, which dilutes their returns.

5.4.2.3.2 Horizon problem

The horizon problem represents a disincentive for members to invest in any relatively long-term cooperative growth projects (Cook and Iliopoulos, 2000). The problem occurs when an owner's claim on the net cash flow generated by an asset is shorter than the productive life of that asset (Porter and Scully, 1987). In such instances, the return to the owner is less than the return generated by the asset. The horizon problem arises in a cooperative because a member's residual claims are tied to his patronage of the business, and because traditional cooperative equity is non-tradable and does not appreciate in value to reflect expected future cash flow generated by the underlying cooperative asset[54]. Because of the illiquid and non-appreciable nature of cooperative equity, once a member ceases to patronize the business, he is no longer entitled to any net cash flow generated by the cooperative asset after this period. As such, the member will only have an incentive to invest in assets whose benefits are generated during the same period in which he intends to patronize the cooperative. If there are restrictions on the transferability of residual claimant rights (for example, the absence of a liquid secondary market through which such rights can be traded), then the member will not realize the full benefits from the investment unless he remains a member for the duration of the productive life of the cooperative asset.

As a result of the horizon problem, members will tend to support only those organizational activities that generate benefits during the period in which they use the cooperative. As such, members tend to support investment activities that maximize short-

[54] This contrasts with a typical IOF, whose horizon of residual claims is unlimited because its common stock represents rights to the firm's net cash flows over the life of the organization (Chaddad and Cook, 2003).

term rather than long-term returns (Fulton and Gibbings, 2000). The horizon problem is most pronounced when dealing with intangible assets that tend to generate long-term rather than short-term benefits for the organization, such as research and development costs, product branding, or projects that require major capital expenditures in the short term but that will not generate positive economic returns until several years later. As Sexton (1997) explains, these sorts of project strategies pay off over the long run for the cooperative, but current members will rationally reject such strategies if they do not expect to personally benefit from them[55]. Members will encourage the firm to maximize short-term benefits even though the present value of long-term growth projects may be greater for the organization[56].

5.4.2.3.3 Portfolio problem

The portfolio problem arises when there is a mismatch between the risk-return preferences of an individual member and the risk-return profile of the cooperative, and when there is no mechanism through which the member can adjust his cooperative investment portfolio to align with his personal preferences for risk taking and his personal wealth (Royer, 1999). The portfolio problem arises where a cooperative's residual claims are not transferable, have no mechanism to appreciate or depreciate in value, and are illiquid. Because cooperative residual claims are not tradable, members' ability to diversify or concentrate their asset portfolios to reflect their personal risk preferences is

[55] Jensen and Meckling (1979) describe a similar horizon problem in labour-managed firms: Due to the absence of marketable claims on future cash flow streams, projects which require long investment and development periods and whose payoffs occur far into the future are less likely to be undertaken by labour-managed firms.
[56] Fama and Jensen (1983b) describe the horizon problem more generally, stating that when the horizon of residual claims is less than the life of the organization, the residual claimants will assign zero value to cash flows that occur beyond that horizon.

hindered, and the resulting distribution of risk is inefficient[57] (Porter and Scully, 1987). Some members may be forced to accept more risk than they prefer, whereas others may feel the cooperative is too conservative. Having no mechanism by which they can adjust their individual equity holdings, members will have an incentive to pressure the cooperative's board and management to alter the organization's investment activities so they become more in line with their personal risk preferences. For example, this may occur if a relatively conservative member feels that a cooperative's strategic decision to enter new areas of business activity entails too much risk to the organization.

As Staatz (1987) points out, growers invest in agricultural cooperatives as a means to strengthen their farm businesses. Because the grower's cooperative investment is linked to his use of the business, the grower is not able to diversify his investment portfolio to the extent that an independent investor in an IOF can, who is free to buy and sell shares and diversify his investment portfolio. Furthermore, since the cooperative is engaged in agricultural activities related to the grower's own operations, the grower is not well-diversified from an investment perspective and as such, he may pressure the cooperative's management to adopt more conservative business strategies than would an otherwise comparable IOF. This incentive to pressure management is reinforced by the fact that growers' investments in cooperatives are largely sunk in that they cannot easily redeem their equity, even if they no longer patronize the business. Faced with an inability to withdraw capital from the cooperative to signal their dissatisfaction with the firm's

[57] As Porter and Scully (1987) note, Jensen and Meckling (1979) have described the portfolio problem in the context of labour managed firms, and their arguments are also applicable to cooperatives. In this regard, Jensen and Meckling note that the non-marketability of residual claims prevents the specialization of risk bearing across individuals with different degrees of risk aversion and wealth, which leads to an inefficient distribution of risk. Moreover, the portfolio problem will lead members to demand higher rates of return on potential investments, and will affect the types of projects undertaken by the firm.

activities, members must rely on voicing their concerns to the board and management. In contrast, investors in an IOF can sell their shares if they disagree with the firm's activities. By doing so, IOF investors voice their disapproval by selling their stock.

5.4.2.3.4 Capital and the free rider, horizon, and portfolio problems

The free rider, horizon, and portfolio problems share a common theme in that all contribute to the difficulty cooperatives have in sourcing capital, as they reduce members' incentive to provide capital to the organization. As a result, growth in cooperatives is constrained because of the tendency to underfinance this type of organization[58]. Whereas IOFs can raise funds from a wide pool of investors through the sale of shares, traditional cooperatives primarily rely on their members for funds, and thus the pool of potential investors is relatively limited. Cook (1997) points out that many cooperative managers and writers have agreed that capital constraints are the most difficult challenge facing today's cooperatives.

The lack of incentive to contribute capital partly relates to the lack of transferability, liquidity and appreciation mechanisms for exchange of cooperative equity. Moreover, these problems relate to the tied nature of cooperative equity to patronage. In a traditional cooperative, contribution of equity is 'tied' to the decision to patronize the business, which makes capital acquisition for a cooperative considerably different from raising equity in an IOF[59]. In the latter, the decision to provide investment capital and the decision to patronize the business are entirely separate. The tied nature of cooperative

[58] Insufficient capitalization of cooperatives is discussed in greater detail in Chaddad and Heckelei (2003).
[59] As explained by Royer (1999), a cooperative is a tied-equity firm in that its residual claims are contractually tied to a claimant's transactions with the firm instead of capital investments.

equity to member patronage can make it difficult for cooperatives to attain the level of capital needed to pursue organizational growth plans. In an effort to mitigate this constraint, most cooperatives retain earnings in the form of member equity. However, there is typically a requirement that the equity be returned to members in the future through some sort of equity redemption plan. As such, cooperative member equity can be viewed as a form of debt for the organization, and the requirement to redeem equity to members at some point in the future places a burden on the cooperative's asset base which may hinder the firm's ability to pursue growth opportunities[60]. Furthermore, retained member equity is typically redeemed at book value, and therefore does not necessarily reflect the market value of the cooperative's activities and the associated return on investment from those activities to the member (Cook and Iliopoulos, 2000).

The tied nature of cooperative benefits to patronage also reduces the incentive for non-members (i.e. those who are not users of the business) to provide capital to the organization. Because the distribution of cooperative earnings is based on patronage rather than investment, non-members do not have an incentive to provide capital to the organization. As Cook (1997) points out, capital markets are generally not interested in providing capital to cooperatives because of the illiquidity and non-appreciability that characterizes cooperative equity. This lack of non-user incentive compounds a cooperative's ability to source capital.

[60] As Staatz (1987) points out, although a cooperative's equity redemption activities place demands on the firm's cash flow and reduce its equity base, the same cannot be said for a shareholder in an IOF who decides to sell his stock on a secondary market. Although the shareholder has transferred ownership through the sale of his shares, this does not affect the IOF's equity base.

Capital-related challenges become more pronounced for a cooperative when the industry in which it operates undergoes structural change itself. For example, the increasingly integrated nature of the agri-food value chain implies a greater need for cooperatives to obtain sufficient levels of risk capital to pursue growth-related strategies and remain competitive[61]. However, the free rider, horizon, and portfolio problems render this difficult to achieve, and therefore inhibit the ability of traditional cooperatives to become part of 21st century agri-food chains (Cook and Iliopoulos, 1998). In this regard, Cook (1997) points out that the difficulty in acquiring equity, combined with the emphasis on short-term rather than longer-term investments created by the horizon problem, have been blamed for the lack of significant cooperative investment in capital-intensive and global industries. In a similar vein, Sexton (1997) asserts that difficulties associated with a cooperative's structure (such as the horizon problem) place the organization at a competitive disadvantage in increasingly concentrated markets.

Adjustments to a cooperative's property rights structure can mitigate the capital-related challenges associated with the free rider, horizon, and portfolio problems. In particular, establishing transferable and appreciable equity instruments through some sort of liquid secondary market provides members with the ability to capture the full value of their investment, without adversely affecting the cooperative's capital base. With access to a liquid secondary market, members can adjust their level of investment in the cooperative to more closely align with their personal risk preferences, thereby reducing the portfolio problem. Moreover, because the present value of the cooperative's

[61] In a study conducted to assess capitalization strategies of agricultural cooperatives, Ernst & Young (2002) similarly noted that globalization, industry consolidation, technology costs, and equity redemption demands from retiring farmers are increasing the need for additional capital in cooperative organizations.

estimated future income streams is incorporated into the value of the traded stock, members who wish to realize the full value of their investment may do so by selling their equity. By doing so, the horizon problem is reduced, as the member no longer has to match the duration of his patronage with the productive life of the underlying cooperative asset. The establishment of tradable and appreciable shares also helps to reduce the free rider problem[62], as existing members capture the full value of their investment, and new members would not dilute these returns (Cook and Iliopoulos, 2000).

5.4.2.3.5 Control problem

The control problem relates to principal-agent conflicts that can arise between the cooperative's membership and their representative board of directors (i.e. the principal) and the organization's management (i.e. the agent). In this context, the control problem is associated with the costs involved in trying to ensure the agent acts in the best interests of the principal. Although agency problems can arise in any organization that separates decision and risk-bearing functions (Fama and Jensen, 1983a), several researchers assert that principal-agent conflicts are more pronounced in traditional cooperatives (Cook, 1995; Porter and Scully, 1987; Harte, 1997). This occurs because cooperative management is not subject to the same external monitoring pressures such as publicly-quoted stock prices, the threat of takeover, and other public information reporting that tend to discipline management behaviour in IOFs.

[62] Cook and Iliopoulos (2000) also point out that closed membership policies and the use of contractual marketing agreements have also been used as tools to mitigate the free rider problem.

For publicly-traded IOFs, control is exerted by shareholders through both their voting rights (and the resulting board of directors governance structure) and through the public trading of the entity's stock. In terms of the latter, the quoted market price for a company's stock indicates shareholders' collective assessment of management's decisions and the company's future cash flow potential. In this manner, the share price is an external monitoring mechanism which serves as a form of 'decision control' by the shareholders to ensure management is acting in their best interests[63] (Fama and Jensen, 1983a). As Staatz (1987) notes, cooperatives do not have these external monitoring mechanisms to influence managerial behaviour. If IOF investors are not satisfied with the organization's performance, they can signal their dissatisfaction by selling its stock, which puts downward pressure on the share price. A poorly-performing share price hinders management's ability to raise additional capital, and may also harm their own well-being if their personal remuneration partly depends on company stock options. As a result, tradable equity shares represent a mechanism to mitigate control problems, as they increase management's incentive to act in the interests of owners.

The lack of a secondary market for cooperative shares implies that members have no simple indicator like a traded share price to gauge how well management has enhanced the future earning potential of the firm, and no means to sell their equity if they are dissatisfied. Moreover, without an external monitoring mechanism such as a tradable share price, cooperative members may instead be tempted to evaluate management based on current earnings. If so, then they will be reinforcing the horizon problem, as they will

[63] As described by Fama and Jensen, (1983a), "stock prices are visible signals that summarize the implications of internal decisions for current and future cash flows. This external monitoring exerts pressure to orient a corporation's decision process towards the interests of residual claimants" (313).

be favouring short-term earnings at the expense of longer-term investment potential. Without a public share market or other external sources of information to gauge managerial performance, cooperatives require an effective form of internal monitoring[64]. In this regard, a cooperative's board of directors may play a more active role in firm decision-making than that of an IOF (Staatz, 1987).

5.4.2.3.6 Influence costs problem

The influence costs problem arises when a cooperative can engage in a wide range of activities and its decisions affect the distribution of wealth or other benefits among members, and when members in pursuit of their self-interests attempt to influence these decisions[65] (Cook, 1995). As explained by Staatz (1987), cooperative members are interested in not only the firm's overall financial performance but also its decisions with respect to the individual goods and services it provides to members as users of the business, as these decisions can impact individual members' farming operations. This contrasts with the owner of a typical IOF, whose interest lies solely in the firm's overall financial performance. Given these differences, business decisions concerning goods and services offered, such as price setting and cost allocation decisions, become much more delicate issues for management in cooperatives than they are in IOFs. Members with diverse interests will attempt to influence the cooperative's decisions so that their outcomes align with their own self-interests. For example, a significant influence cost

[64] Porter and Scully (1987) summarize why internal monitoring becomes particularly important for cooperatives: "Since the members' shares cannot exchange in the market, and since the net cash flow cannot be capitalized and sold, there is no external information available to the principals through which the performance of the agent (manager) can be evaluated. In the absence of external information, internal monitoring must be used to make judgements on managerial performance" (497).

[65] The concept of influence costs in agricultural cooperatives is examined in greater detail in Cook and Iliopoulos (1999b).

can arise when members in a particular area want their local facility (such as a grain elevator) to remain in operation, even though the overall performance of the cooperative would benefit from its closure. In such a situation, the cooperative may incur excessive operating costs if the facility remains open, or may require a significant degree of the board's and management's time in dealing with members if the decision is made to close the facility. Such activities represent influence costs to the cooperative.

The extent of influence activities partly depends on the degree of homogeneity of cooperative members and the procedures that govern decision-making in the organization (Cook, 1995). The fact that most cooperative directors are elected on a regional basis facilitates the influence costs problem, as elected directors may have an incentive to favour decisions that please their constituents, even though such decisions may be to the detriment of the cooperative's membership overall. In this respect, cooperative organizations tend to be more political than IOFs, as directors may feel compelled to respond to the demands of growers who elected them. Moreover, growers may use the election process as a forum in which to express concerns about particular operational issues, rather than focusing on which candidates have the skills required to oversee sometimes large, complex organizations. The influence costs problem will also be exacerbated with an increasingly heterogeneous membership, as growers have diverging interests because of differences in farming size, location, etc. For example, a cooperative may have a membership comprised of farmers nearing retirement and downsizing the scale of their farming operations, large-scale farmers, and beginning farmers. All may have different preferences in terms of what they want the cooperative to achieve. However, under a democratic cooperative voting arrangement, each one would be entitled to one vote, and therefore have equal ability to influence the decision-making process[66]. The influence costs problem also tends to be larger for cooperatives that have complex, diversified operations (O'Connor and Thompson, 2001).

The inability of members to liquidate their cooperative equity exacerbates the influence cost problem, as disgruntled members have no means by which to exit the cooperative by selling their equity. Instead, these members must express their dissatisfaction through their elected directors. In contrast, dissatisfied investors in an IOF can sell their stock and take their investment capital elsewhere (Trechter et al, 2003). As a result of influence activities, operational business decisions may be more costly to undertake in cooperatives than in IOFs. Not only do members often want to be involved in these decisions through their elected directors, but because of the diversity of member interests it may be difficult to reach a consensus on what the appropriate decision should be. In contrast, in an IOF these types of decisions can generally be made by management without any involvement from the firm's owners (Staatz, 1987).

5.4.2.4 Stage four

The cooperative enters stage four as its decision-makers become increasingly aware of these property rights problems and the difficulties they create in managing the business and planning for the future. At this stage, the organization's board and management must consider the tradeoffs between the benefits of its cooperative nature, the problems

[66] In this respect, Cook (1997) notes that a one member-one vote democratic voting arrangement may make it difficult for farmers who represent a large proportion of cooperative business and want the organization to move in a new or more global direction, but in terms of voting rights represent a small number of the overall membership.

associated with its property rights structure, and the organization's strategies for the future. Eventually three general alternatives are considered, which Cook (1995) terms as 'exit', 'continue', or 'shifting'. As this occurs, the cooperative enters the fifth stage of its life cycle, at which point implementation of the chosen alternative occurs.

5.4.2.5 Stage five

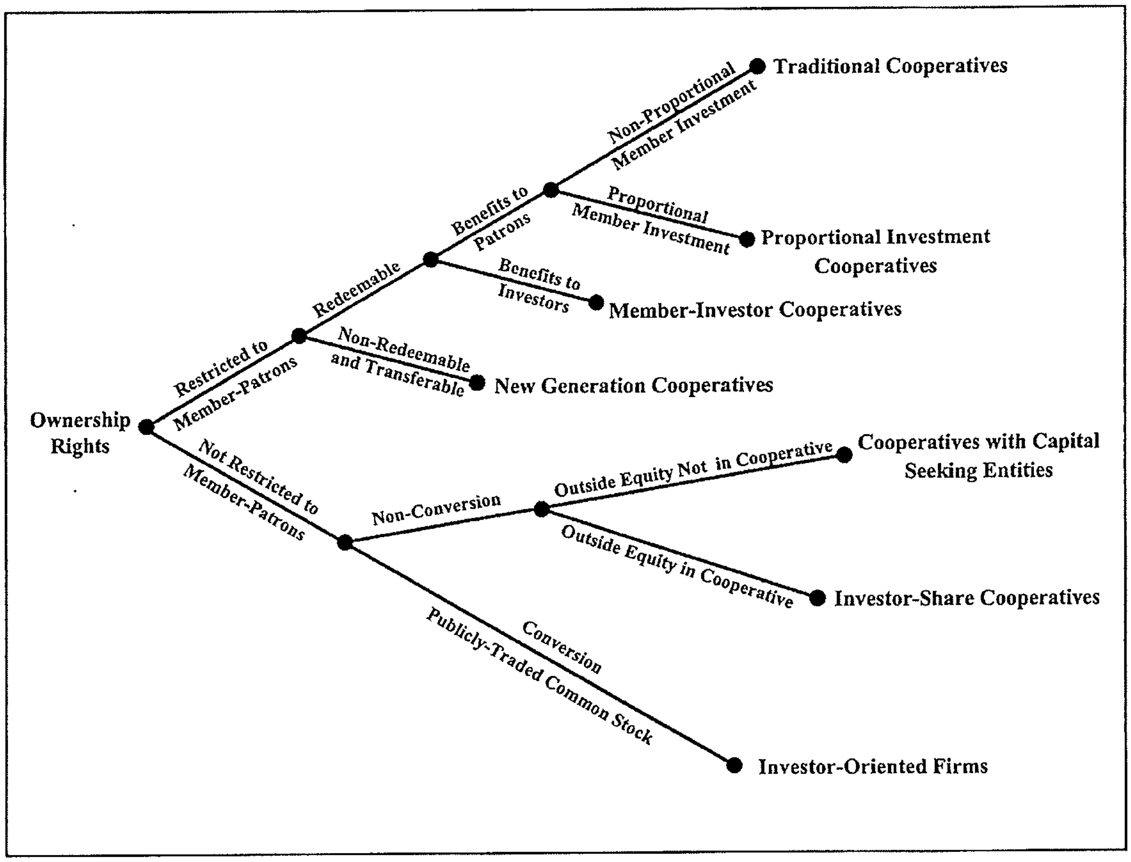
During stage five, cooperatives attempt to alleviate their property rights constraints by one of three general alternatives described by Cook (1995) as: 1) exiting, through methods such as converting to an IOF structure or merging with a larger entity; 2) continuing in a modified cooperative form; or 3) shifting into a different type of cooperative, commonly referred to as a 'new generation' cooperative (NGC). Regardless of the particular path chosen—exit, continue, or shifting—cooperative strategies at this later point in the life cycle are more offensive in nature when compared to the more reactionary, defensive approach that tended to characterize their formative stage.

Cook describes the decision to 'exit' the industry as involving several options: liquidate the cooperative's assets and cease operations, merge with another entity, or restructure the organization into an IOF. The decision to 'continue' as a cooperative entails making structural changes to ameliorate the tendency for undercapitalization of the firm. In this respect, two alternatives exist. First, the cooperative may seek outside (i.e. non-member) equity capital without restructuring into an IOF. This may involve establishing strategic alliances with equity-providing partners, joint ventures, or publicly-held subsidiaries. Second, a decision may be made to maintain the cooperative structure but implement some form of proportionality strategy, in which members are required to share financial responsibility by contributing capital according to some proportional basis, for example, through a base capital plan[67]. The third general alternative identified by Cook is 'shifting' into an NGC, which is a value-added form of marketing cooperative. In this scenario, the cooperative attempts to mitigate its vaguely-defined property rights problems by adopting a structure that includes an asset appreciation mechanism and share liquidity; a base equity capital plan; and a closed membership policy[68].

More recent studies by Cook and others[69] have elaborated on alternative organizational structures that traditional cooperatives have adopted in recent years. This body of work suggests that cooperatives are increasingly adapting to industry changes by experimenting with innovative forms of organization that mitigate some of the problems associated with the traditional cooperative structure. For example, based on case study evidence from various countries, Chaddad and Cook (2003, 2002) identify a variety of non-traditional organizational structures whose characteristics lie somewhere in between a traditional cooperative and an IOF. The authors describe five non-traditional models of cooperative organization that relax some of the restrictions associated with traditional cooperative property rights. Three of these non-traditional structures acquire capital from members only, whereas the others seek out risk capital from outside (i.e. non-user) interests and therefore no longer restrict ownership to members. Chaddad and Cook's typology of alternative cooperative organizational forms is presented in Figure 5.1.

[67] In a base capital plan, the firm calculates its capital needs, and then determines each member's minimum capital requirement based on his average use of the business over some base period. Based on this result, those members who are under-invested must contribute additional capital to the firm, and those who are over-invested receive equity redemptions.
[68] In an NGC, members are required to invest in the firm through delivery rights that give the holder the right to deliver a stipulated amount of commodity to the firm. Delivery rights can be traded on a secondary market, which provides liquidity and the opportunity for members' equity to appreciate in value.
[69] For example, Cook and Iliopoulos (1998), Sykuta and Cook (2001), Chaddad and Cook (2002, 2003).

Figure 5.1 Typology of alternative cooperative forms



Source: Chaddad and Cook (2002)

The proportional investment, member-investor, and NGC models in the upward portion of Figure 5.1 represent organizational models that limit ownership to the firm's members, yet alter some of the features of a traditional cooperative's residual claims in order to improve members' incentive to provide capital. In the proportional investment model, members are required to invest in the cooperative in proportion to patronage through policies such as base capital plans. In a member-investor cooperative, the firm distributes net earnings in proportion to member shareholdings rather than patronage, through policies such as distributing cash dividends, issuing bonus shares, or allowing shares to appreciate in value. Because they are remunerated for their investment, members have an increased incentive to invest in the organization. The NGC model represents Cook's (1995) 'shifting' alternative, which was described earlier.

In contrast to the three models in the upward portion of Figure 5.1, the models in the downward portion introduce equity capital from non-member sources. As such, ownership rights are no longer restricted to users of the business. The most extreme case in this respect is outright conversion to an IOF, which represents an 'exit' strategy described by Cook (1995). However, other forms of organization that maintain some degree of user-ownership while introducing non-user equity sources are possible. In this respect, Chaddad and Cook (2002, 2003) describe two models: cooperatives with capital-seeking entities, and investor-share cooperatives. In the former, the cooperative brings in outside capital indirectly through a separate or partly-owned legal entity such as a subsidiary, strategic alliance, or trust company. In the case of an investor-share cooperative, the organization brings in outside equity by issuing a separate class of shares that may have different rights in terms of residual claims and control than those allotted to the cooperative's members. For instance, the cooperative may issue preferred shares or non-voting common shares to outside investors, and a separate class of voting shares to its members. In this manner, the organization is able to obtain risk capital from outside investors while maintaining traditional member control through a separate class of voting shares[70]. Both the members and outside investors are owners of the cooperative, albeit with different rights to residual claims and control.

[70] As an example of an investor-share cooperative, Chaddad and Cook (2002) identify Saskatchewan Wheat Pool (SWP), which in 1996 converted its members' equity into B-Class common shares and subsequently listed the share class on the Toronto Stock Exchange. In this manner, these shares can be freely traded among farmers and non-farmers alike. SWP also issued A-Class voting shares to its farmer-

Although all of the alternative organizational forms presented in Figure 5.1 differ in terms of their particular property rights arrangements, each retains a cooperative-like grower orientation to some degree, in contrast to the investor focus of a typical IOF. In light of this, the term "producer-oriented firms" has been used to describe these hybrid organizational forms. As Sykuta and Cook (2001) explain:

> The defining characteristic for these firms is not so much their adherence to the traditional definition of a cooperative, but their orientation toward the producer rather than to the independent investors...Indeed, an investor-owned firm whose shareholders are predominantly producers for the organization would also be a producer-oriented firm (1277).

5.4.3 Fulton and Gibbings (2000)

In a study conducted for the Canadian Co-operative Association, Fulton and Gibbings (2000) identify many of the same external and internal pressures facing cooperatives at the beginning of the 21st century as described by Cook (1995) and Royer (1999)[71]. As part of their research, the authors undertook case studies of various cooperatives in the U.S., Canada, the EU, and Australia. Fulton and Gibbings concluded that external factors such as the industrialization of agriculture, globalization, government withdrawal of subsidies and funding for research and development, and changes in technology and consumer preferences have encouraged a shift towards increased vertical coordination and integration along the supply chain. Moreover, the authors assert that those with the greatest source of power and control in the supply chain will be those who

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members. Unlike its listed B-Class shares, these voting shares are non-transferable and non-appreciable. According to Ketilson (1997), the purpose of SWP's restructuring was to raise permanent risk capital to enable the organization to pursue an aggressive strategy of diversification and investment in value-added downstream processing, while simultaneously maintain member control of the organization.

[71] In this respect, Fulton and Gibbings (2000) note: "Co-operatives are conditioned by the external environment in which they operate and by a set of internal forces that affect the behaviour of the members and the management of the co-op. Partly because of the place many co-operatives are in their life cycle and partly because of the changes occurring in the rest of agriculture, the internal pressures are building at precisely the same time that the external environment is being fundamentally altered. The result is that co-operatives are under tremendous pressure to change" (5).

are close to consumers and therefore have knowledge of consumer demand, and those who have proprietary genetic information at the input stage. Cooperatives must determine where to position themselves within this modern integrated supply chain.

In terms of internal factors, Fulton and Gibbings (2000) assert that pressures for change can often be linked to a cooperative's lack of well-defined property rights, in that members do not appear to have a well-defined set of rights or claims to the cooperative's assets or the benefits it provides. The authors recognize the five property rights problems described by Cook (1995), and contend that a lack of well-defined property rights arises because cooperative equity is not typically traded, benefits derive from use rather than investment, and because voting is based on membership rather than capital invested or the level of business conducted. Moreover, they argue that these problems become more pronounced as the cooperative matures because of the increasing heterogeneity of its membership and the increasing complexity of its operations. In its early stages, a cooperative's membership is comprised of a relatively homogeneous group of farmers in a local geographic area who share common goals, and the organization engages in a relatively narrow set of activities. As farmers become more heterogeneous, however, and as the cooperative moves into new areas of activity and grows in size, it may experience less cohesion among its membership who may feel little incentive to provide capital to the organization. Factors such as these will make the cooperative exceedingly difficult to manage. The authors contend that members need a strong sense of ownership and control in order to give them an incentive to invest in the cooperative.

Similar to Cook (1995), Fulton and Gibbings (2000) contend that cooperatives must adapt to these external and internal factors if they are to remain viable in the 21st century. Ongoing external pressures will encourage cooperatives to become bigger through activities such as mergers and acquisitions, expanding their geographic reach and integrating further along the supply chain. In terms of internal pressures, the authors observe that cooperatives have begun to alter their property rights structures in order to provide members with a greater incentive to contribute capital, encourage long-term organizational investments, and engage in proper monitoring and control of the organization. Fulton and Gibbings note that much of the adaptation that has occurred among traditional cooperatives to date has resulted from pressures arising from property rights problems. This is consistent with Cook's (1995) life cycle theory, in which property rights problems play a pivotal role in cooperative organizational change.

5.4.4 Trechter et al (2003)

Recent work by Trechter et al (2003) has also contributed to the study of cooperative evolution. The authors examine structural changes to two organizations, AWB and New Zealand's Fonterra Dairy Group (Fonterra)[72]. Based on their observations, the authors assert that organizational changes undertaken by AWB and Fonterra represent strategic responses to external changes in the food and fiber sector, and to inherent weaknesses of their traditional cooperative structures. In this latter respect, Trechter et al recognize the five property rights problems identified by Cook (1995) and the related difficulties traditional cooperatives have in sourcing equity. From this perspective, the authors

[72] Formed in 2001, Fonterra represents the amalgamation of a number of New Zealand's traditional dairy cooperatives and its single desk marketing authority, the New Zealand Dairy Board.

contend that Fonterra, in its overall drive to save costs and become a major competitor in global dairy markets, chose to adopt many of the structural characteristics associated with the NGC model[73]. As part of its strategy to compete globally and as a means to leverage its members' equity, Fonterra has also entered into various strategic alliances with other dairy companies. Trechter et al contend that Fonterra's structure, as well its dominant position in the New Zealand dairy market, has enabled the organization to mitigate the free rider, horizon, and portfolio problems commonly associated with traditional cooperatives; however, control problems and influence cost problems remain.

In terms of AWB's transformation into AWB Limited, Trechter et al (2003) contend that the organization has become a "cooperative-share corporation hybrid", which has mitigated some of the property rights problems associated with the traditional cooperative structure, particularly those related to equity sourcing challenges. However, the authors caution that AWB Limited's dual class share structure will lead to conflicts between growers and non-growers if equity is increasingly held by non-growers, and that significant differences between grower and non-grower investors will create pressures that may lead to the eventual loss of grower control of the organization[74].

5.4.5 Potential problems of cooperative restructuring

Although the adoption of non-traditional organizational structures may alleviate some of the property rights problems previously encountered, researchers such as Trechter et al

[73] In particular, dairy farmers must purchase shares in proportion to the quantity of milk they wish to deliver to Fonterra, but can also trade their shares back to Fonterra at fair market value. Voting rights are based on the amount of milk delivered.

[74] Based on the case study of AWB Limited conducted in chapter six, observations similar to those of Trechter et al (2003) are noted in chapter seven.

(2003) and Chaddad and Cook (2003, 2002) caution that other challenges may arise as a result of cooperative restructuring. For instance, agency costs, collective decision-making problems, and influence costs may increase. In the case of non-traditional structures that include outside (i.e. non-user) equity, conflicts may arise between the interests of members and those of outside investors. In such an arrangement, members may have to share profits and eventually control rights with outside investors, which may result in conflicting organizational goals of maximizing returns to investors and maximizing returns to members as users of the business. Fulton and Gibbings (2000) note similar possibilities, in that the more a cooperative's property rights are restructured like those of an IOF, the greater the likelihood the organization will begin to behave as an IOF. In particular, if benefits are allocated on the basis of capital invested rather than use, then larger shareholders will have an incentive to direct the organization's management to increase shareholder value rather than meeting the needs of users. Torgerson et al (1997) refer to a similar problem which they describe as 'goal inversion', in which the organization places a greater priority on maintaining 'corporate values' than keeping the business oriented to members as its primary beneficiaries[75].

Given these possibilities, cooperative leaders must consider the potential tradeoffs involved in any organizational restructure. In this respect, although the information presented here has focused on potential weaknesses of a traditional cooperative structure, several unique advantages of this structure have also been recognized (for example, see Cook and Illiopoulos, 1998), and must also be considered in the decision-making process.

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[75]In a similar context, Hind (1997) has noted the tendency for cooperative organizational objectives to become increasingly corporate as opposed to member-focused over time.

5.5 Summary

Using a NIE approach, various researchers contend that a traditional cooperative's structure of property rights, namely the user-oriented design of its residual claim and control rights, may result in different incentives and organizational behaviour than that found in otherwise comparable IOFs. Moreover, these differences may create problems for cooperatives, particularly when the industry in which they operate undergoes structural change itself. Cook (1995) has presented a life cycle model which contends that agricultural cooperatives re-examine their property rights structures as they mature. During this evolutionary process, cooperatives adapt by undertaking strategic alternatives that may involve significant organizational restructuring.

In a review of Cook's (1995) seminal work, King (1995) noted that cooperative life cycle theory provides a framework which can be further tested and refined through historical case studies[76]. In this regard, the work of Fulton and Gibbings (2000) and Trechter et al (2003) have contributed to this effort by observing cooperative change in various countries and incorporating Cook's concepts into their analyses. This thesis will further contribute to research in this area by undertaking case studies of five major Australian agribusinesses and applying cooperative life cycle theory to the Australian experience. As will become evident in the case studies, although these Australian organizations have evolved from their more traditional cooperative roots, they have all maintained grower-driven characteristics, similar to Sykuta and Cook's (2001) definition of a producer-oriented firm.

[76] Fulton and Gibbings (2000) have also noted that much of the knowledge that is important to cooperative adaptation is contextual in nature, and as such they also encourage case study research.

Chapter 6 Case Studies

6.1 Introduction

In early 2004, five major Australian agribusinesses are engaged in the marketing, storage and handling of Australian wheat and barley. These companies are: AWB Limited, ABB Grain, GrainCorp, AusBulk, and CBH. All five of these organizations have evolved from beginnings as marketing authorities or bulk handlers that operated like grower cooperatives with exclusive government-granted privileges[77]. The case studies presented in this chapter detail each organization's transformation to its current corporate structure and strategic business activities. Although private (i.e. non-government owned), some of these organizations have maintained exclusive marketing rights granted by federal or state governments. Where applicable, these arrangements are also described, as they play an important role in the industry and the interrelationships that currently exist among the organizations and Australian growers. Given its relative importance to the industry as the single desk exporter of bulk Australian wheat, AWB Limited is afforded somewhat greater focus in this chapter than the other entities.

The case studies reveal that all five entities have undertaken strategies of growth and diversification in order to remain viable in an increasingly competitive marketplace. At the same time, all five entities have adopted structures that retain formal grower control of the organization. Table 6.1 provides an overview of the five organizations and some of their significant features as they existed in 2003.

[77] Figure 1.1 provided an outline of the evolution of these five agribusinesses.

Table 6.1 Overview of Australian agribusinesses in 2003

	AWB Limited	ABB Grain***	AusBulk***	GrainCorp	CBH
Organizational structure	Dual class share model; Grower control maintained through exclusive A Class voting shares; B Class equity shares traded on ASX; ownership not restricted to growers	Dual class share model; Grower control maintained through exclusive A Class voting shares; B Class equity shares traded on ASX; ownership not restricted to growers	Holding company model; Grower control maintained through majority shareholding held by grower-owned holding company (UGH); Shares currently tradable on an introductory market, but intends to list on ASX in 2004	Holding company model; Grower control maintained through unique "Foundation Share" held by grower-owned holding company (GGA); Ordinary shares traded on ASX; ownership not restricted to growers	Cooperative; Member equity is non-tradable and non-appreciable; Ownership restricted to growers
Core business	Marketing, primarily wheat; financial and risk management products and services to growers	Marketing, primarily barley; includes export marketing alliance with CBH subsidiary	Bulk handling	Bulk handling (major geographic expansion through mergers with former state BHAs of Victoria and Queensland)	Bulk handling (Western Australia)
Other major business activities	Storage and handling; Chartering services; Grain technology	Financial and risk management products and services	Marketing; Malting: Australia's largest maltster; world's 8th largest commercial maltster	Marketing; Milling: Joint venture with Cargill in Australia's largest milling operation	Marketing (through merger with Grain Pool of WA); Engineering services
Storage capacity	3 million tonnes; 50 per cent ownership in one export terminal; joint venture in logistics with CBH in Western Australia	None	10 million tonnes; 7 export terminals	25 million tonnes (includes capacity of merged Grainco); 9 export terminals	16.5 million tonnes; 4 export terminals
Average profit*	$75 million	$13 million	$31 million	$31 million	$52 million
Assets**	$2.4 billion	$226 million	$709 million	$606 million	$799 million
Equity**	$932 million	$132 million	$409 million	$275 million	$629 million
Exclusive government-granted rights	Export single desk for bulk Australian wheat	Export single desk for bulk South Australian barley	None	Export single desk for NSW barley, canola, sorghum; domestic rights for NSW malt barley. Scheduled for removal in 2005.	Export single desk for Western Australian barley, lupins, and canola

*Profit from ordinary activities after income tax expense. Four-year average, 1999-2000 to 2002-03
**Based on annual report for the year ended 2003
***ABB Grain and AusBulk announced merger agreement in May 2004
Information in Table 6.1 obtained from company-sourced documents

6.2 AWB Limited

6.2.1 Introduction

As a result of its single desk export marketing rights for bulk Australian wheat, AWB Limited plays a significant role in the Australian grains industry. Since deregulatory changes were introduced to the former statutory AWB in 1989, the organization has evolved into a diversified agribusiness that is increasingly positioning itself as a significant player in the Australian and global markets, not only in its traditional role as a grain marketer, but more importantly in other business segments such as financial lending and risk management services to growers. AWB Limited's vision is to become Australia's leading international manager of agricultural commodity assets and services (Stewart, 2004). Through a dual class share structure, AWB Limited is a grower-controlled organization whose equity is publicly traded on the Australian Stock Exchange (ASX). Among the five organizations examined in this thesis, AWB Limited is the largest in terms of capital and market size.

6.2.2 Origins and organizational change

AWB Limited evolved from the former AWB, a statutory authority that was established in 1939 to act as the single desk marketer of Australian wheat on behalf of growers. Major features of AWB's operations prior to 1989, and the significant legislative changes made to its operations in that year, were described in chapters three and four, respectively. After legislative changes were introduced in 1989, the GCA[78] realized that industry changes would continue, and it therefore decided to take a more

[78] As described in chapter three, the GCA (formerly the AWF) is the major grower lobby group in the Australian grains industry, and has historically played a significant role in liaising with government on matters concerning industry arrangements.

proactive role in coordinating a strategic planning process to guide the industry's future[79]. In this respect, the GCA organized a 'Grains 2000' initiative in 1989, which included a conference on the challenges facing the industry, a set of commissioned research papers, and the establishment of several sector-specific 'strategic planning units'. The Grains 2000 initiative served as the starting point of work towards a substantially new structure for the AWB. Arising from this process was the recognition that, given the various changes that were occurring both domestically and abroad, the AWB would need a much greater degree of flexibility if it was to succeed in the medium to longer term (Ireland, 1998).

As part of the Grains 2000 initiative, a strategic planning unit for the wheat sector was formed. This group comprised a wide range of industry stakeholders, including the GCA, AWB, the federal government, and representatives from Australia's bulk handlers and flour millers. The group commissioned a professional consulting firm to undertake an extensive study of the industry. The study examined Australia's situation in the context of the world wheat market and its outlook for the future. After ten months of study, the consultants concluded in 1995 that AWB was unsustainable in its current form if further deregulation was to occur: Given the ultra-competitive nature of the world wheat trade, the consultants asserted that AWB was too small and insufficiently integrated to compete with the likes of multinationals such as ConAgra if further

[79] The GCA's executive director describes the realization that the GCA needed to take a more proactive approach as follows: "...it became clear to the [GCA] during the division and uncertainty of the debate surrounding the Royal Commission into Grain Storage, Handling and Transport, and the "great wheat debate" in the lead up to the 1989 *Wheat Marketing Act*, that the processes by which it formulated and implemented policy were overly reactive, inadequate and would, in all likelihood, prove ineffective in the face of substantial and continuing change within the Australian industry and the international market" (Hooke, 1994: 53).

deregulation occurred. Not only would AWB have to extend its trading activities to grains other than wheat, but it would also have to vertically integrate, furthering its involvement in the value chain beyond its current focus on trading, including establishing a position in storage and handling. The consultants noted that the vast majority of Australian wheat growers wanted the AWB to remain as the single desk export marketer, as they felt that deregulation of the export market would decrease their control over the industry and possibly lower profits. In terms of organizational structure, the consultants recommended corporatization of AWB (i.e. removing formal government ownership), as this would enable the organization to increase its focus on the 'bottom line', which would be critical for long term success (Booz, Allen & Hamilton, 1995).

After the release of the 1995 report, the GCA held extensive grower meetings across the country to discuss how AWB should be structured beyond 1999, when government underwriting of its borrowings was scheduled to cease[80]. At these meetings, growers identified five key objectives that any future AWB structure should achieve. These grower-identified objectives are listed in Table 6.2.

Table 6.2 Key grower objectives to be retained in any AWB restructure

1. Retention of the single export desk;
2. Grower control and/or ownership, with the ability for growers to access their equity in AWB;
3. An adequate capital base to ensure a strong commercial entity with the ability to maintain adequate first advance payments to growers;
4. A commercial structure which reflects market signals, provides commercial flexibility and maximizes returns to growers;
5. Industry self-determination and certainty and efficiency in structural arrangements.

Sources: GCA (1997); AWB (1998)

[80] As described in chapter four, legislative amendments made in 1992 stipulated that government guarantees on AWB borrowings would cease in 1999.

A working party comprised of representatives from the GCA, AWB and the federal government was subsequently formed to evaluate possible future structures for AWB, and professional legal and financial consultants were appointed to assist in this process. The consultants considered a number of alternative models, keeping in mind the five key objectives desired by growers. Essentially, these five objectives involved various corporate and financial components that had to be met by any restructure. For example, any organizational structure would have to provide for grower control, but would also need to provide liquidity and be conducive to future capital raisings; be acceptable to international capital markets (where AWB did the majority of its borrowings); and simultaneously provide an acceptable return on capital while continuing to maximize export single desk pool returns to growers. As well, questions surrounding the appropriate structure for grower control needed to be answered, such as whether voting rights should allocated on the basis of one vote per grower or volume of business conducted. AWB's future borrowing needs had to be considered, keeping in mind the expected level of single desk advance pool payments to growers, the capital needs of the organization's cash trading and other non-single desk business activities, and the related financial and risk components that credit agencies would take into account when establishing AWB's credit rating without the government guarantee. Taxation implications of alternative structures also had to be considered.

During their evaluation of possible organizational structures for a privatized AWB, the consultants examined a number of agricultural cooperatives in other countries that had undergone recent restructurings. Included among these were Canada's SWP and various Irish dairy cooperatives. The primary motivation behind these cooperative restructurings was the requirement for additional capital, in light of the fact that many of the organizations had recently experienced rapid growth in terms of both geographic scope and business lines, and found their existing cooperative structures to be a constraint. In all but one case, these organizations chose a dual class share structure as the primary means to restructure, as this enabled cooperative members to maintain control while simultaneously allowing the organization to obtain additional capital for future growth. External (i.e. non-grower) providers of equity were entitled to receive dividends and have some level of voting power. In some cases, limits were placed on the level of individual shareholdings, which helped to maintain organizational control by growers.

The consultants considered the feasibility of limiting AWB's future capital sources to growers only (i.e. no outside equity contributions), through a process of revolving the WIF capital base. However, they concluded that such an arrangement would be not be appropriate for several reasons: First, growers' investment in the WIF would be relatively illiquid, as the revolvement period would most likely be longer than 10 years. Second, such an arrangement would limit AWB's capacity to manage its capital base and access additional capital, which may adversely affect its credit rating and borrowing capacity, and thus the level of advance pool payments it could provide to growers.

Three organizational structures that were considered as possible alternatives for a privatized AWB were a capital trust structure, an ordinary equity model, and a dual class share model. In a capital trust structure, the capital trust (comprised of the WIF funds) would guarantee the borrowings of a group of subsidiaries that would undertake AWB's operational activities (i.e. export pool management, cash trading, value-added investments, etc). In such a structure, control of the organization's capital would be separated from control of its operating activities. The consultants concluded that, although a capital trust structure would meet the grower objectives of grower control and industry self-determination, the separation of control of the organization's operating activities from control of its capital base was cumbersome and would not be viewed favourably by capital markets.

A second possible structure was an ordinary equity model, in which the organization would have a single class of shares conveying both ownership and control rights. In such an arrangement, WIF funds would be converted into ordinary shares that provided each holder voting rights and the opportunity to earn a rate of return on investment. Such an arrangement would meet the grower-identified objectives regarding an adequate capital base and a flexible commercial structure. However, because such shares could be transferable to non-growers, the ordinary equity model would not satisfy the objectives of grower control and industry self-determination. Although these objectives could be met by placing restrictions on the amount of shares held by non-growers (for example, by stipulating that growers maintain at least a 51 percent ownership stake in the organization), such restrictions would limit share liquidity, as the pool of potential investors for a majority of the stock would be restricted to growers.

The third major alternative structure considered for a privatized AWB was a dual class share model. Under such an arrangement, AWB would have two classes of shares to represent the source of organizational control and equity, respectively. In terms of control, one class of shares would be issued only to growers, at a nominal value, and would have voting rights to elect a majority of directors to the board. This class of shares would not be eligible for dividends. In terms of organizational equity, the WIF funds would be converted into another class of shares, which would have limited voting rights to elect a minority of the board of directors, but would be eligible to receive dividends, and thus the opportunity to earn a commercial rate of return. Although this share class would initially be held solely by growers at the time of WIF conversion in 1999, growers would eventually be asked to approve listing the shares on the ASX. The other class of control shares would remain unlisted and restricted to growers.

The consultants recommended the dual class share model, asserting that it met all five grower objectives for AWB's restructure (GCA, 1997). The working party encountered considerable difficulty in agreeing on a preferred option, however, partly as a result of disunity among the GCA's state affiliates[81]. In particular, Western Australia was not satisfied with a proposed voting system that was based on the democratic principle of one vote per grower. Its opposition reflected the fact that, on average, Western Australian growers were larger in terms of wheat production than other states' growers, and they would thus be disadvantaged in a corporate governance system in which all growers, regardless of size, had the same voting rights. In order to appease such concerns, a compromise was reached where the proposed structure's voting rights were changed to partly reflect individual growers' wheat volumes delivered (Ireland, 1998).

[81] One industry observer has described the GCA's internal debates about AWB's privatization as a "civil war" among its member affiliates (Bolt, 1999a). The prolonged negotiations about the proper structure for a privatized AWB reflected state-based concerns that other states would gain unfair voting control in the privatized organization, or more importantly, whether any possibility remained for outside investors to seize control of the organization (Bolt, 1999b)

Ultimately, a form of dual class share model, referred to as a 'grower corporate model', was recommended for AWB's restructure by the working party to the federal government. The Minister for Primary Industries and Energy endorsed the new structure, stating that it would successfully balance the objectives of grower ownership and control with commerciality (Anderson, 1997). Among other things, the grower corporate model was also designed to have enough flexibility so that, in the event the Australian government decided to further deregulate the market in the future, the company would be able to adjust and continue as a viable commercial entity (Flugge, 1998).

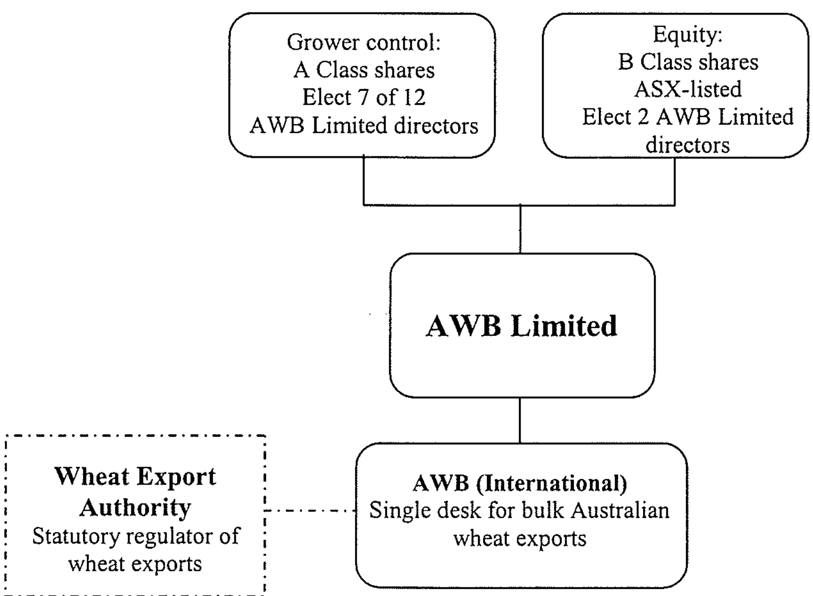
The legislative process[82] to restructure the statutory AWB began in late 1997 and culminated in its privatization July 1, 1999, the date on which government underwriting of AWB's borrowings ceased. Privatization was designed to separate the commercial and regulatory functions that had previously co-existed in the statutory AWB. Effective July 1, 1999, AWB Limited became an unlisted company with a dual class share structure. All commercial functions of the former statutory AWB were transferred to the grower-owned and controlled AWB Limited and its group of wholly-owned subsidiaries. A Class 'controlling' shares were issued to 36,618 growers, and WIF units were converted into B Class shares on a one-for-one-basis, effectively becoming the capital base of AWB Limited[83]. Also at July 1, 1999, a new independent statutory authority—the WEA—assumed responsibility for regulatory control of Australian wheat exports. In accordance with the legislation, AWBI, a wholly-owned subsidiary of AWB Limited, was granted an

[82] The legislative process occurred in two stages, mainly to provide a transition period to allow AWB sufficient time to assure financial lenders and credit rating agencies that its privatized structure would warrant a credit rating similar to the one held when the government guarantee on borrowings was in place.
[83] At the time of privatization, the WIF had over 67,575 equity holders and was valued at $606.9 million (AWB Limited, 1999).

exclusive exemption from the WEA's export control functions, which thereby allowed the single desk wheat export arrangements to continue. Effectively, since July 1, 1999 the commercial functions of the export single desk for bulk Australian wheat are carried out by a private company (AWB Limited, more specifically its subsidiary AWBI) on behalf of Australian wheat growers. Whereas AWB Limited and its wholly-owned subsidiaries (including AWBI) operate under Australian corporations law, the statutory WEA and the related export control mechanisms are legislated through the *Wheat Marketing Act 1989*.

Figure 6.1 outlines the organizational structure of AWB Limited, as well as the role of the statutory WEA in relation to the subsidiary AWBI.

Figure 6.1 AWB Limited organizational structure[84] and the statutory WEA



[84] For simplicity, Figure 6.1 does not include all of the various subsidiaries operated by AWB Limited.

6.2.3 Organizational structure in 2004

The AWB group of companies consists of a parent company, AWB Limited, and a number of wholly-owned subsidiaries responsible for operating its various business segments. AWB Limited has a dual class share structure, A Class and B Class, which represent the source of organizational control and equity, respectively. A Class shares represent the source of control as they carry voting rights to elect a majority of the company's directors (7 out of 12, including the board's chairman). These shares can only be issued to current wheat growers[85] and must be redeemed when the holder ceases to be a grower. A Class shares are issued at a nominal amount, are non-tradable and are not entitled to dividends. A grower can hold only one A Class share; however, voting rights are somewhat proportional to a grower's quantity of wheat delivered[86]. At September 30, 2003, AWB Limited had 33,502 A Class shareholders (AWB Limited, 2003a).

B Class shares represent AWB Limited's equity capital. In August 2001, AWB Limited publicly listed its B Class shares on the ASX[87]. The main purpose of listing was to provide growers who held B Class shares the ability to trade their shares at a fair value in a liquid and transparent market. At the time of listing, AWB Limited also issued $100 million of new equity, in order to increase share liquidity and raise additional capital to finance further expansion of the company's operations (AWB Limited, 2001b).

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[85] To be eligible for an A Class share, a grower must deliver at least an average of 33 1/3 tonnes of wheat per year.

[86] Each A Class shareholder has one vote, plus additional votes based on the following formula: an additional vote if his or her average annual tonnage of wheat delivered is more than 33 1/3 tonnes per year for the past three years; plus an additional vote for each 500 tonnes, or part thereof, per year of average annual tonnage delivered by the A Class holder above 500 tonnes per year for the past three years.

[87] AWB Limited's stock has also been included in Standard & Poor's ASX/S&P 100 index since October 2002. Inclusion in the ASX/S&P 100 index facilitates demand for AWB Limited's stock from index-linked fund managers (Bolt, 2001d).

B Class shares are tradable and can be held by both growers and non-growers alike[88]. However, no individual shareholder can own more than 10 per cent of the B Class shares on issue. These shares carry the right to receive dividends and the right to elect a minority of AWB Limited's board of directors (two out of 12 board members[89]). In terms of voting rights, a shareholder has one vote for each B Class share held. According to AWB Limited's former chairman, Trevor Flugge, minority voting rights were attached to the B Class shares to mitigate the potential for loss in value that could otherwise occur when the time came for their public listing on the ASX. Such a discount in value could arise because, even though B Class shareholders provided the company with risk capital, they would not be given control of the organization[90]. Flugge (1998) explained the decision to attach minority voting rights to the B Class shares as follows:

> The advice initially from BT Australia [AWB's corporate restructuring advisor] was that the dual class model is a measure of control. In other words, it puts control in the hands of the producers...We do not oppose that, but there is a penalty for that because, when those (B Class) shares are listed, it means that people who may not necessarily have a share in B Class will in fact have control of the company and, therefore, can limit the growth of the company, can limit the ability of that company to develop. The shares will take a penalty when listed, or even unlisted; they will take a penalty on the fact that they do not have control. If you are comparing a single class share company to a dual class share company, there is a penalty (122).

Mr. Flugge gave the example of a "sister organization", Canada's SWP, and its public issuance of non-voting shares on the Toronto Stock Exchange, which he contended were probably trading at a 20 per cent discount to what they would have been had they been conferred with voting rights equal to that of SWP's non-tradable voting shares,

[88] The company has stated in 2003 that almost 85 per cent of its B Class shares are owned by growers (AWBI, 2003).
[89] AWB Limited's board of directors consists of 12 members, 7 of which are elected by A Class shareholders, 2 of which are elected by B Class shareholders, and 2 of which are appointed, based on their particular skills. The remaining board member is AWB Limited's executive managing director.
[90] A similar comment has been made by another financial analyst, who noted that the potential for clashes of interest between growers and investors in AWB Limited's share structure makes the stock less attractive relative to other entities that do not have this sort of structure (Bolt, 2002e).

which can only be issued to growers (Flugge, 1998). According to Mr. Flugge, the role of capital provided by AWB Limited's B Class shareholders, and the associated risk to which this capital is exposed when financing advance payments to growers, is a major reason why these shares include minority voting rights:

> So there is significant risk in guaranteeing a (harvest) payment up front. That capital base must take risk. This is why it has been very important to make sure that that capital which takes risk is put in such a way that people who are going to put that capital up have some control, some influence over it. If you do not give them some say on the board, even if it is a minor say, if you do not give them some control and some votes in the structure, they are not going to put that (capital) up if there is a significant risk there (Flugge, 1998: 123).

Because of their exclusive entitlement to dividends, B Class shareholders carry the sole right to participate in the profits of the company. At September 30, 2003, there were 63,522 B Class shareholders and 315,161,984 B Class shares issued, with a book value of over $848 million (AWB Limited, 2003a).

6.2.3.1 The export single desk and AWB Limited's constitutional objectives

AWB Limited (more specifically, its wholly-owned subsidiary AWBI) plays a significant role as the single desk exporter of bulk Australian wheat. Given Australia's heavy reliance on export markets relative to domestic consumption, the vast majority of Australian wheat is exported. As a result, AWBI's export single desk represents about 80 per cent of total wheat produced in Australia (AWB Limited, 2002c)[91]. Because of its responsibility to operate the export single desk on behalf of Australian growers, both AWB Limited and its subsidiary AWBI have a required objective to maximize net pool returns to growers who deliver to the National Pool (the formal name given to the export

[91] Given the company's export single desk status and Australia's size in terms of world wheat trade, AWB Limited (including its subsidiaries) is the world's second-largest wheat exporter, representing 16 per cent of global market share in 2001-02 (AWB Limited, 2003b).

single desk). AWBI has no employees of its own. Instead, it contracts with the parent company, AWB Limited, to operate and manage the National Pool. The services provided by AWB Limited to AWBI include international sales and marketing, risk management (including foreign exchange and commodity price management), grower services (including grower payments), research and development (including varietal selection and setting receival standards), and supply chain management of export wheat. The terms and conditions of these services are stipulated in a service agreement between AWBI and AWB Limited. In return for providing these services, AWB Limited receives a performance-based remuneration[92], which is designed to provide the company with a financial incentive to maximize National Pool returns to growers and in doing so, earn a reasonable commercial return for its shareholders (WEA, 2003).

As a result of its government-granted single desk privileges and its dual class share structure, the AWB group of companies (i.e. AWB Limited and its subsidiaries) must serve the objectives of both growers who export wheat through the single desk as well as B Class shareholders who expect to earn a commercial rate of return on the risk capital they have provided to AWB Limited. As a result of these dual objectives, AWB Limited differs from typical shareholder-owned companies whose sole objective is to maximize shareholder value. Because of its single desk responsibilities, grower objectives relating to export pooling have formally been given priority over those of its B

[92] Under the terms of the agreement, AWB Limited receives a base fee, as well as an out-performance incentive fee from AWBI if its performance in managing the single desk exceeds established benchmarks, subject to an overall cap (AWB Limited, 2003b).

Class shareholders[93]: The corporate constitutions of both AWB Limited and its subsidiary AWBI stipulate that the organization's primary objective is to undertake grain trading activities and investments with a view to maximizing net pool returns to growers:

> In relation to wheat growers who sell pool return wheat to the company or its subsidiaries, to maximize their net returns from the pools by securing, developing and maintaining markets for wheat and wheat products by minimizing costs as far as practicable (AWB Limited Constitution, Article 2.3(a)).

The constitutional requirement to maximize pool returns to grain growers is unique to AWB Limited; no other organization in Australia has this formally embedded in its corporate mandate (Scales, 2003; Lindberg, 2003). In addition, the constitution stipulates that the board of directors must ensure that AWBI is managed with the objective of maximizing net pool returns to growers who sell wheat into the pools, and that net pool returns are distributed to these growers. With respect to B Class shareholders, the company's constitution states: "...the Directors may have regard to the desirability of providing B Class Shareholders with a reasonable commercial rate of return and the possibility that further capital may need to be raised" (AWB Limited Constitution, Article 3.3), but this does not remove their obligation to maximize net export pool returns to growers. In essence, AWB Limited must ensure that its priority is to maximize pool returns to growers; however, the company must also provide an acceptable return to its B Class shareholders, otherwise it risks losing continued access to capital at reasonable cost[94].

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[93] AWB Limited's chairman, Brendan Stewart, has described this priority as follows: "The issue of where shareholders and pool participants sit is very clear in the minds of all the board members and the management of the AWB group. Our overriding obligation is to the pool participants. The constitution and the act lay out very clearly that they are the people who take the highest priority" (Stewart, 2003: 128).

[94] AWB Limited's managing director, Andrew Lindberg, has recognized the need to provide B Class shareholders with a reasonable return on their investment, but also acknowledges that the company's obligation to maximize pool returns to growers is viewed as a discounting factor in capital markets: "...I think we are entitled under the constitution to make reasonable returns on activities that we undertake to

6.2.4 Business activities

Referring to itself as "Australia's major national grain asset manager" (AWB Limited, 2002a), AWB Limited engages in five major business streams: export pool management services[95]; financial and risk management products and services; grain acquisition and trading; supply chain and other investments; and grain technology. Through these various business segments, the organization is actively involved in several stages of the value chain, including plant breeding and seed sales, storage and handling, financing (including agricultural lending to growers), grain marketing (including trading grains other than wheat), ship chartering, and offshore investments that include flour milling, food processing, and international trading activities.

A significant area of AWB Limited's business is the offering of financial products and risk management services to growers, in order to help manage their pricing uncertainty and cash flow needs during the crop year. Since its privatization in 1999, finance and risk management services has represented the main source of profit for AWB Limited[96]. The company earns revenue from these activities by charging interest rates and underwriting fees for the various financial products offered and deriving profit margins on these activities. The focus on profit-driven financial services represents a major difference between the statutory AWB and the private AWB Limited. As a

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support the pool. Clearly, in our commercial ventures we aim to get an acceptable return for the capital that we put at risk. It is a fact, it is clear, and the market no doubt rates that in our price-earnings multiple and our stock. There is no doubt that our stock trades at a discount because of some of the restrictions that are placed on AWB Limited, the company, in the way it has to conduct its business" (Lindberg, 2003: 131).

[95] Export pool management services comprise the services provided by AWB Limited to AWBI to operate and manage the National Pool, as described in section 6.2.3.1.

[96] AWB Limited's emphasis on deriving profit from its financial and risk management services has led some industry observers to comment that the organization has become more of a financial institution rather than a traditional agricultural company (Chessel, 2001).

statutory entity, AWB borrowed at a government-backed credit rate and passed this cost onto growers on a cost recovery basis. In contrast, the for-profit AWB Limited captures a profit margin on funds borrowed, in order to secure a return on investment to shareholders (GGA, 2002c). A major part of the finance business is offering various loan and payment option products to growers who deliver to AWBI's National Pool[97]. AWB Limited competes with other institutions such as Australian banks and other grain companies that offer similar financial products to growers, including AusBulk, CBH, and GrainCorp, who are offering harvest finance products as part of their efforts to expand beyond their traditional role of grain storage and handling (GGA, 2002c). However, AWB Limited has a dominant market share in this business segment: it is estimated that the company maintains a market share of over 80 per cent in providing harvest finance products to growers (GGA, 2003b).

AWB Limited's grain acquisition and trading activities consist of domestic wheat trading as well as trading in grains other than wheat, both domestically and abroad[98]. Other grains traded by AWB Limited include barley, sorghum, and canola. Since domestic deregulation in 1989, AWB Limited has maintained a significant presence in the domestic wheat market: For example, the company estimated its domestic market share to be about 35 per cent in 2002-03. AWB Limited has recently expanded its grain trading capabilities overseas by creating a new subsidiary based in Geneva, Switzerland, whose

[97] The most popular product among growers is the AWB Harvest Loan, which enables the grower to receive the majority of cash flow at time of delivery (AWB Limited, 2003b).

[98] AWB Limited's grain acquisition and trading activities are separate from its activities related to the export single desk. Given the profit motive of its trading activities as opposed to the pool maximization objective of AWBI, business rules have been established to ensure that information transferred between AWB Limited's trading division and its National Pool managers do not compromise the company's constitutional requirement to maximize net pool returns to growers (AWB Limited, 2003b).

functions include the trading of non-Australian commodities, including other origin (i.e. non-Australian) wheat[99] (AWB Limited, 2003b).

In terms of its supply chain and other investments, AWB Limited entered the storage and handling sector for the first time in 1999, when it built a facility in the state of Victoria. AWB Limited's stated reasons for entering the storage and handling sector are to increase competition and cost efficiency in the system, and to achieve a strategic market share of production (AWB Limited, 2003b). As mentioned in chapter four, section 4.4.2, the organization's entry into the storage and handling sector has been a major source of tension among the traditional bulk handlers. They believe that AWB Limited is unfairly encroaching on their traditional business segment while they cannot in turn fully compete with AWB Limited in its traditional business of grain marketing, as long as the latter's single desk export privileges remain in place. In recent years, a particularly contentious issue in this respect was whether AWB Limited would expand its storage and handling activities into Western Australia and thus become a direct competitor of that state's traditional bulk handler, CBH. As CBH's chairman described it, "all hell will break lose" if AWB Limited had made the decision to do so (Watson, 1999). After several years of acrimony and uncertainty, in December 2003 AWB Limited announced that it had entered into a joint venture agreement with CBH to unify the two company's grain logistics activities in Western Australia. In addition to the joint venture agreement with CBH in Western Australia and the building of its own infrastructure in

[99]Business rules have been established to ensure that AWB Geneva cannot enter into any transaction that could harm AWBI's role as the single desk exporter of Australian bulk wheat. Furthermore, AWBI has the power to veto any proposed wheat sale that AWB Geneva wishes to undertake (Senate Rural and Regional Affairs and Transport Committee, 2003).

eastern Australia, AWB Limited has also made attempts to merge with other bulk handlers: In 2003, the organization put forth a merger proposal to GraincoAustralia (Grainco), Queensland's former statutory bulk handler. However, Grainco instead chose to merge with another traditional bulk handler, GrainCorp[100].

In addition to storage and handling, AWB Limited is also involved in ship chartering services and downstream investments. As part of its strategy to further diversify its revenue sources and secure end-use demand for its products, AWB Limited has several offshore investments, including a 30 per cent equity stake in Egypt's largest private flour mill, which is also one of AWB Limited's largest customers. The company also has ownership interests in both a Vietnamese and Chinese mill, as well as a joint venture relationship with Zennoh, Japan's largest agricultural cooperative. AWB Limited also made an attempt to become a significant player in Australia's domestic milling industry by bidding for the assets of Australia's largest miller, but was denied by the Australian Competition and Consumer Commission because of competition concerns arising from AWB Limited's role as the single desk exporter of wheat and its position as the largest domestic trader (Bolt, 2002c)[101].

AWB Limited is also actively involved in grain technology at the input stage. Its involvement includes a joint venture with life science company Syngenta to develop new varieties, as well as a wholly-owned subsidiary responsible for the commercialization of new seed varieties and other seed sales. Given its export single desk status, AWB

[100] The merger of Grainco and GrainCorp is described in GrainCorp's case study, section 6.5.2.
[101] The milling assets were instead purchased by a joint venture between Cargill Australia and GrainCorp (as described in GrainCorp's case study, section 6.5.4).

Limited also plays a major role in controlling the quality of Australia's wheat exports, as it is responsible for approving and classifying Australian wheat varieties, as well as establishing the receival standards for all wheat delivered to the National Pool.

AWB Limited has formally identified two major strategies for the future: strengthen its core wheat business; and grow and diversify. Strengthening its core wheat business involves continuing to manage the export single desk, reducing costs in the supply chain by increasing the competitiveness of the storage, handling and transportation sectors, and establishing a larger role in seed technology. In its efforts to grow and diversify, the company intends to pursue both horizontal and vertical expansion. This will include not only broadening the range and volumes of grain and other commodities it manages, but expanding its range of financial and risk management products and investing in related processing opportunities (AWB Limited, 2003b).

AWB Limited undertook its most significant step to date towards growth and diversification in 2003, when it purchased Wesfarmers' Landmark Limited (Landmark) for $825 million[102]. Landmark is Australia's largest supplier of agricultural inputs such as fertilizer, as well as a major provider of a broad range of other rural products and services, including financial services. Landmark is also involved in the marketing of livestock and wool products. AWB Limited views several benefits arising from the Landmark acquisition, including the diversification of its grain revenue base across a broader range of agricultural products and farm inputs; providing strong growth

[102] AWB Limited's purchase of Landmark has been described as the biggest corporate deal in Australian agriculture (Bolt, 2003b; Clegg, 2003).

opportunities, particularly in financial services; and improving market access for Australian agricultural products (AWB Limited, 2003c). Several observers have commented that the Landmark acquisition provides AWB Limited with the size required to compete globally with major U.S. multinationals such as ConAgra and Cargill, as well as the diversification needed to prepare for the possibility of losing its export single desk privileges (Clegg, 2003; Cave, 2003). AWB Limited itself has noted that as a result of the Landmark acquisition, it has become Australia's first sizeable, integrated business that has the ability to compete with major international grain players (King, 2003).

6.3 ABB Grain Ltd.

6.3.1 Introduction

ABB Grain Ltd. (ABB Grain) is the successor to the former statutory barley marketer, the ABB. Since privatization, ABB Grain has focused on strengthening its grain marketing capabilities and financial products and risk management services to growers. As one of the smaller organizations in the industry, ABB Grain has been involved in several merger discussions with other Australian entities during recent years, including AusBulk in early 2004. ABB Grain and AusBulk have announced their intention to merge, subject to shareholder approval in September 2004. Through a dual class share structure, ABB Grain is a grower-controlled organization whose equity is publicly traded on the ASX.

6.3.2 Origins and organizational change

ABB Grain's predecessor, the ABB, was first established in 1939 by the Commonwealth government, through the *National Security Act (1939)*, as a statutory authority responsible for the marketing of Australia's barley crop. In 1942, this authority was narrowed to apply only to South Australian and Victorian barley, and responsibility for the entity was transferred from the Commonwealth to the respective state governments, who each passed the necessary state legislation to enable ABB to compulsorily acquire and market the state's barley crop.

In 1997, the Victorian and South Australian governments commissioned a joint NCP review of their respective barley marketing legislation. The review recommended deregulation of the domestic market, retaining the export monopoly for only the 'shortest possible transition period', and restructuring ABB into a private grower-owned company (NCC, 2002). The two state governments subsequently decided in 1998 to privatize ABB, setting a target date of July 1, 1999 for privatization to take effect. A working party was formed, comprised of members from ABB, the governments of Victoria and South Australia, and members of the states' two major farm organizations, South Australian Farmers Federation and Victorian Farmers Federation. The same corporate and financial advisors[103] that were appointed to help with the AWB restructure were also used in the ABB restructuring process. Similar to the AWB restructuring, it was determined that ABB would be transformed into a grower-owned and controlled company, operating under Australian corporations law with a dual class share structure. As stated by the company's chairman, such a structure "was designed to unlock the value embedded in the organization and attribute it to individuals, while at the same time ensuring that growers would retain control of the new company" (Day, 1999). Grower control of the company would be assured through the issuance of one class of shares ('A

[103] These two companies were Bankers Trust and Mallesons Stephen Jacques.

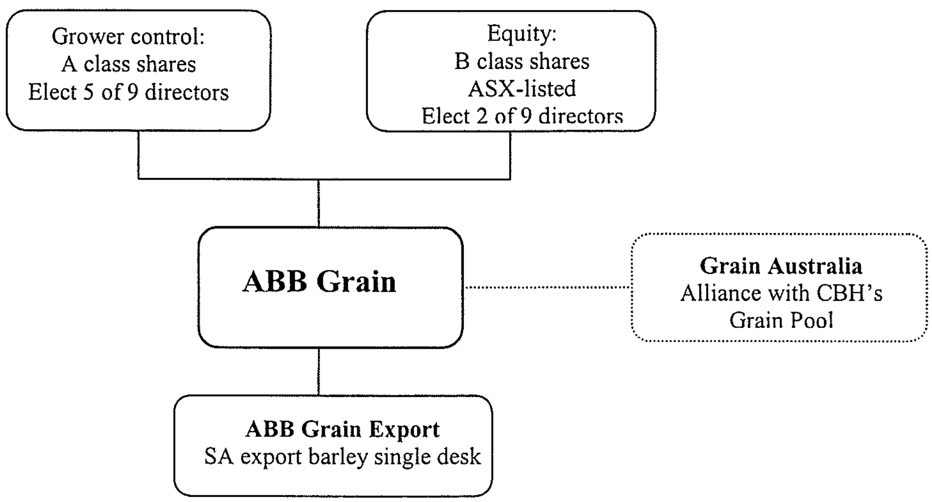
Class') to growers only, who would retain the voting power to elect the majority of directors to the board. The design of these shares was a key strategy in "blending the 'grower cooperative' nature of pool sales with a commercial company structure" (Day, 2001). Another class of shares ('B Class') would represent the financial base of the company, and it was anticipated that these shares would eventually be publicly listed on the ASX. At the time of privatization, these shares were created from approximately $35 million in ABB reserves, and distributed to growers on the basis of an individual grower's volume of business conducted with ABB in the four seasons up to and including 1998-99. ABB Grain listed its B-Class shares on the ASX in 2002, at which time it also raised $22 million in additional equity to help finance company expansion.

In terms of barley marketing deregulation, the Victorian and South Australian governments removed their domestic barley marketing single desks effective July 1, 1999. Victoria removed its export barley single desk two years later, on June 30, 2001. Although it initially agreed with Victoria to remove its export single desk in 2001, the South Australian government reversed its decision in 2000, citing overwhelming grower support. The government extended the export monopoly indefinitely, but required a scheduled review of the monopoly to begin in 2002[104] (NCC, 2002). In order to accommodate the remaining export single desk arrangements in the ABB restructuring, a wholly-owned subsidiary, ABB Grain Export Ltd. (ABB Grain Export), was established.

[104] As discussed in chapter four, the South Australian government's response to this review, completed in 2003, is pending.

Figure 6.2 presents ABB Grain's organizational structure in 2004, including the role of its subsidiary single desk exporter, ABB Grain Export. The figure also depicts Grain Australia, an export marketing alliance that has been established between ABB Grain and CBH's marketing subsidiary, Grain Pool Pty Ltd (Grain Pool).

Figure 6.2 ABB Grain organizational structure



6.3.3 Organizational structure in 2004

ABB Grain's A-class shares can only be held by active grain growers[105]. Only one A-class share is issued to each grower, but the share entitles the grower to cast one vote for each 25 tonnes of grain produced and delivered. In this manner, A-Class shareholders elect five of the nine directors, who are growers themselves. A-Class shares are valued at a nominal amount, are non-tradable, and are not entitled to dividends. Approximately 12,000 A-Class shares were issued at time of privatization. At September

[105] ABB Grain considers an active grain grower to be a person who produces and delivers to the company an annual equivalent of 25 tonnes or more of grain, calculated as a three-year moving average.

30, 2002, the number of A-Class shareholders was 12,334[106]. B-Class shares represent equity ownership in ABB Grain. These shares can be held by anyone, grower or non-grower[107], subject to no individual owning more than 15 percent of the B-class shares. These shares are eligible to receive dividends and have limited voting rights: B-class shareholders elect two of the organization's nine directors[108].

In line with its single desk responsibilities, the objective of the subsidiary ABB Grain Export is to maximize net export pool returns to growers. A service agreement dictates the interaction between ABB Grain Export and its parent, ABB Grain, in order to ensure transparency between the two and to delineate between the profit-seeking activities of ABB Grain and the single desk role of ABB Grain Export.

6.3.4 Business activities

ABB Grain provides grain marketing and related risk management services and financial products (such as underwriting of pool payments) to growers. The company is Australia's largest barley marketer. Approximately half of the world's trade in malting barley is undertaken either by ABB Grain directly or through its export marketing alliance[109] with CBH's Grain Pool subsidiary, which operates the single desk for exports of Western Australian barley, canola, and sorghum, and is Australia's second-largest barley marketer. Domestically, ABB Grain is the largest supplier of malting barley to

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[106] Of these shareholders, the vast majority reside in two states: South Australia (56 per cent) and Victoria (41 per cent) (ABB Grain, 2002).
[107] According to ABB Grain, in 2004 approximately 10 per cent of B-Class shares are currently owned by non-growers, with a further 5 to 10 per cent owned by former (i.e. retired) growers.
[108] The two remaining directors are appointed, one of whom is ABB Grain's managing director, and the other of whom is appointed based on his or her special expertise (i.e. financial, corporate skills, etc).
[109] Known as Grain Australia, this export marketing alliance was formed in 2001.

Australia's malting companies (ABB Grain, 2002). Although the primary product marketed is barley, ABB Grain has been expanding its activities in other grains and oilseeds, including domestic wheat, in order to increase its business base and provide a fuller range of products to customers. In order to increase its grain marketing capabilities[110], the company acquired a grain trading group, Jossco, in 2003, which supplies the Australian domestic market with a variety of grains and oilseeds, and is also a major participant in the export of Australian sorghum, oats, and field peas. Jossco also trades in grains from other countries, and has a significant presence in New Zealand (ABB Grain, 2003). The Jossco acquisition has complemented ABB Grain's efforts to expand beyond its traditional geographic territory of Victoria and South Australia. Expansion of activities along Australia's eastern seaboard is a key part of ABB Grain's strategy to grow its business and reduce the risks associated with localized crop production failures.

ABB Grain does not physically accumulate grain itself. Instead, it uses the services of bulk handlers, most notably AusBulk and GrainCorp, to receive, store, and handle its products. ABB Grain negotiates storage and handling agreements with these companies, as well as logistical arrangements with railways and other transport entities.

In terms of other activities, ABB Grain offers chartering services for its export sales, and has a minor offshore investment in an Egyptian flour and feed mill operation[111].

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[110] ABB Grain has also strengthened its marketing capabilities by acquiring a grain containerization business in 2004. The acquisition is intended to strengthen ABB Grain's role in the exporting of containerized grain, a steadily growing market segment (ABB Grain, 2004b).

[111] AWB Limited also maintains an ownership interest in this Egyptian company, Five Star Flour Mills.

In addition to downstream activities, ABB Grain is involved at the input stage, largely through its ownership interest in Grain Trust, which was established in 2000 by several Australian grain industry participants to commercialize new grain varieties.

Given its relatively smaller position in the industry, ABB Grain has been the subject of merger discussions over the years. In recent years, the organization has had merger talks with AWB Limited and AusBulk. However, no formal agreement with either of these entities was reached (Byrnes, 2002; Bolt, 2002a, 2001b). In early 2004, ABB Grain again entered into merger discussions with AusBulk. Although the two organizations temporarily ceased talks after they were unable to agree on relative company valuations and the role that AusBulk's grower-owned holding company, United Grower Holdings (UGH), would have in the merged entity (ABB Grain, 2004a), they reached a merger agreement in May 2004. The merged entity will continue to operate under the ABB Grain name and will utilize ABB Grain's dual class share structure.

6.4 AusBulk Ltd.

6.4.1 Introduction

AusBulk Ltd. (AusBulk) has evolved from South Australia's traditional bulk handler into a diversified agribusiness engaged in various activities, most notably grain marketing and barley malting, in which it holds a position as Australia's largest maltster. Through a holding company structure, AusBulk is a grower-controlled organization whose equity can be held by both growers and non-growers. As mentioned above, in 2004 AusBulk and its grower-owned holding company, UGH, reached an agreement to merge with ABB Grain. The merged entity will be one of Australia's larger integrated agribusinesses (ABB Grain, 2004c).

6.4.2 Origins and organizational change

AusBulk originated as South Australian Co-operative Bulk Handling Limited (SACBH), which was formed on cooperative principles in 1954 by the South Australian Wheat and Woolgrowers Association, with the specific objective of "establishing, maintaining and conducting a grain handling and storage system for South Australia, owned, controlled and financed by growers" (Whitwell and Sydenham, 1991: 103).

In the late 1990s, SACBH's board of directors and management began an extensive strategic planning process to determine how the organization should be structured for the future. Given the ongoing changes that were occurring in the industry, the organization's leaders decided that SACBH needed to diversify its geographic reach beyond South Australia and to evolve into a more vertically-integrated agribusiness. Moreover, the organization's leaders believed that its traditional mutual structure would not be conducive to this strategic plan. SACBH's chairman described this realization in 1999:

> Whilst the current structure has served members well in the formative stages of the Company, it is not sustainable in the future. A key issue is that the Company has a substantive asset base in excess of $320 million yet members have no direct entitlements in these assets. Moreover, the current structure is likely to be restrictive in a more open, commercial operating environment, in terms of access to alternative sources of capital at competitive rates and flexibility to enter into strategic alliances. Clearly, establishing ownership and improving flexibility have become key imperatives for your board (O'Driscoll, 1999).

SACBH's traditional mutual structure was one in which growers had contributed to its growth and equity by paying storage and handling charges and tolls. However, its status as a tax-exempt company limited by guarantee without share capital prevented it from issuing shares or paying dividends to members. As a consequence, members were prevented from having direct ownership of SACBH's assets, even though they had contributed to the development of those assets over the years (AusBulk, 2000a). SACBH's board of directors established a set of fundamental objectives and other needs that would have to be met by any organizational restructuring. Table 6.3 outlines these identified factors. Foremost to any restructure was the need to enshrine grower control.

Table 6.3 Restructuring objectives for SACBH

Fundamental objectives:

1. To pass direct ownership of SACBH to grain growers through the issue of permanent shares with full capital and income participation rights.
2. To maintain grain growers' control over the activities of SACBH.
3. To ensure that, notwithstanding the need for grower control, no individual shareholder can, through their voting entitlement, exert undue influence over the direction of the Company.

Having achieved these objectives, the restructure must also:

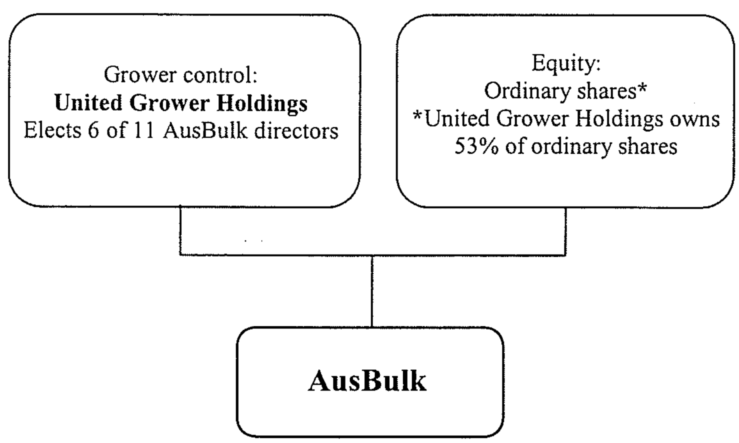
- Treat all members fairly and equitably;
- Ensure members' entitlement to shares is based substantially on deliveries over a reasonable time period to smooth seasonal impacts and shifts in the production base;
- Maximize the value of growers' investment in SACBH and ensure there is a liquid market to trade their equity;
- Enable the Company to grow and take advantage of business opportunities;
- Enhance SACBH's flexibility to meet increasing levels of competition and form strategic alliances with other business parties; and
- Improve SACBH's ability to access capital funds (both debt and equity) on a competitive basis.

Source: SACBH (1999)

After extensive consultations with growers, as well as professional legal and financial advice, SACBH decided on a holding company model for its restructure. At the same time, the decision was made to change the organization's name from SACBH to AusBulk. Through this restructuring, AusBulk would become a share capital corporation, and a holding company, owned by active grain growers, would be established to become its controlling shareholder. The remaining shares of AusBulk would initially be owned by individual growers, but they would eventually be allowed to trade these shares to anyone, including non-growers, and it was anticipated that these shares would be publicly listed on the ASX.

SACBH's members approved the organization's demutualization and restructure in 2000. At the time of restructuring in October 2000, shares were issued to growers, 50 percent directly and 50 percent indirectly via the grower-owned holding company, UGH. Growers' individual share entitlements were based on the tonnage of grain delivered in the previous 10 years. Figure 6.3 depicts AusBulk's restructured arrangements, including the role of the holding company UGH.

Figure 6.3 AusBulk organizational structure



6.4.3 Organizational structure in 2004

UGH was created as a mechanism to ensure grower control of the operating company, AusBulk. UGH maintains control of AusBulk by representing six grower-elected positions on the latter's 11-member board of directors[112]. In addition, AusBulk's constitution limits the size of individual shareholdings other than UGH's shareholding to 15 per cent of total shares issued. UGH is an unlisted company with ordinary shares that can be traded among active grain growers only, subject to a maximum individual shareholding no greater than five percent of issued shares. Active grain growers are considered to be those that grow grain for a significant commercial purpose, in that they must deliver a minimum of 100 tonnes of grain over three seasons to AusBulk. As of November 2003, UGH reported having just under 11,000 shareholders[113] (UGH, 2003a). Voting in UGH is proportional to the number of shares held; however, this is limited in that an individual shareholder's voting power cannot exceed one percent of the total votes attached to issued UGH shares. As mentioned, all six of UGH's grower-directors also sit on the board of AusBulk. UGH's primary asset is its majority shareholding in AusBulk, from which it receives dividends which are subsequently passed on to UGH's grower-shareholders. At September 30, 2003 UGH held a 53 per cent controlling interest in AusBulk (UGH, 2003b).

As an outcome of the merger agreement reached with ABB Grain in May 2004, the organizational structure of AusBulk and UGH will change, as the merged entity will

[112] The remaining five AusBulk directors are non-growers who have been appointed for their various business expertise.

[113] As part of the SACBH demutualization process, UGH shares were issued to approximately 16,000 growers, many of whom were no longer active growers, or who had only received a small amount of shares based on low volumes of grain delivered to SACBH between 1990 and 2000. As part of its efforts to ensure its shareholder base is comprised solely of active growers, UGH undertook a campaign to buy back shares from these growers, resulting in a reduction in its shareholder base from over 16,000 growers to just under 11,000 reported in 2003 (UGH, 2003a).

utilize the dual class share structure of ABB Grain[114]. The merger will involve a scrip-for-scrip swap of all shares in UGH and AusBulk for ABB Grain's B-Class shares. In addition, each AusBulk grower will be able to acquire one ABB Grain A-Class share if he or she does not already hold one. AusBulk growers who already hold A-Class shares will receive additional voting rights. The board of directors of the merged entity will be comprised of a majority of growers (ABB Grain, 2004c).

One of AusBulk's objectives of demutualization was to provide financial returns to growers who helped build the company over the years. As AusBulk has stated, "the problem of the old mutual structure was that while growers had helped create the company they did not reap the benefits that came from direct ownership" (AusBulk, 2002b: 3). According to AusBulk, its transformation from a cooperative mutual to a share capital corporation has created a more flexible capital and share structure that allows the company to achieve growth and effectively respond to industry change. In particular, the restructuring strengthens its ability to expand its handling business to other states, diversify revenue streams to 'drought-proof' its operations, and to be more responsive to future changes, including opportunities for mergers and acquisitions (AusBulk, 2001). Furthermore, AusBulk's chairman has noted that the organization's need to generate profits reflects a desire to return value to growers:

[114] In early 2004, merger talks temporarily ceased after the entities were unable to agree on relative company values. In this respect, a primary concern was the different shareholder bases of the two companies: ABB Grain has a large contingent of Victoria-based growers whereas AusBulk primarily has a South Australian-based set of growers. Because their shareholder bases are not identical, agreement on relative company valuations was critical to ensure there was no wealth transfer from one company's set of shareholders to the other (AusBulk, 2004).

> While AusBulk is focused on service, it still needs to generate a profit to achieve one of the key objectives of the demutualization of the company – to unlock the value of AusBulk and place it in the hands of growers so that, when they retire or exit the industry, they may realize the value of their investment. The problem prior to demutualization was that while growers had helped to build and grow the company, they did not essentially own it. The shares growers now own in AusBulk recognize their contribution to the growth of the company and constitute an asset that will grow and generate income (O'Driscoll, in AusBulk 2002a).

AusBulk's shares are currently tradable on a so-called 'introductory market', which is operated by an independent company that provides services to match prospective buyers and sellers of shares. However, AusBulk has acknowledged that such an introductory market is cumbersome and results in shares trading at a discount. AusBulk indicated its intentions to list on the ASX in the second half of 2004, and appointed an investment banking firm to advise on the details of the listing. However, due to the merger agreement reached in May 2004 with already-listed ABB Grain, the merged entity's shares will continue to be listed on the ASX under the ABB Grain name, and as a result AusBulk no longer has to pursue independently listing. AusBulk's chairman has noted that, because the merger will involve UGH and AusBulk shareholders receiving ABB Grain B-Class shares that are readily tradable on the ASX, this will 'unlock' value for growers whose AusBulk and UGH shares are currently discounted because they are difficult to trade (ABB Grain, 2004c).

6.4.4 Business activities

As part of its strategy to vertically integrate and reduce its reliance on its core business of storage and handling, AusBulk has diversified its business activities in the past several years. Foremost among its non-traditional activities are grain marketing and processing, in particular malting. AusBulk's managing director has described the organization's overall transformation since its bulk handling origins in 1954 as follows:

> AusBulk has now completed its metamorphosis from a one dimensional single function company to one which encompasses a range of business activities between farm gate and end-user to provide value for growers, marketers and shareholders (AusBulk, 2003c).

AusBulk's diversification into marketing and malting reflects its strategy of becoming an integrated service provider in the value chain.

In terms of marketing, AusBulk established a grain marketing division in 1999, and now operates the largest independent[115] domestic wheat trading account and is the country's largest originator of pulses (AusBulk, 2003a). The merger with ABB Grain will increase its marketing capabilities, as it will combine ABB Grain's traditional grain marketing strengths with AusBulk's traditional storage and handling capabilities.

In terms of processing, AusBulk became a major player in the malting industry in 2002, when it acquired two companies, including Australia's largest maltster, Joe White Maltings. As a result of these acquisitions, AusBulk is now Australia's largest maltster and one of the top ten commercial maltsters in the world (AusBulk, 2003d). AusBulk's malting acquisitions were a significant part of the company's strategy to integrate beyond grain storage and handling and become involved with first-stage processing and distribution of grain products (AusBulk, 2002a).

Overall, AusBulk's strategy of diversification to reduce its dependence on storage and handling and the related exposure to seasonal production fluctuations benefited the organization in drought-ravaged 2003: In a year during which excessive drought reduced

[115] I.e. independent of AWB Limited, the export single desk marketer.

its grain handling deliveries from 8.6 million tonnes the previous year to just over 3 million tonnes in 2002-03, AusBulk reported that three-quarters of its profit was generated from its malting and grain marketing divisions (AusBulk, 2003d).

6.5 GrainCorp Limited

6.5.1 Introduction

The first of Australia's statutory BHAs to be privatized, GrainCorp Limited (GrainCorp) has since undertaken significant mergers with two other former statutory BHAs to become the largest bulk handler in eastern Australia. In addition, the organization has diversified its operations to become not only a significant grain marketer, but also the largest player in the domestic milling industry through a joint venture arrangement with Cargill Australia. As a result of these diversification and expansion efforts, GrainCorp has become a powerful agribusiness rival to AWB Limited along Australia's eastern seaboard (Dodd, 2004). Through a holding company structure, GrainCorp is a grower-controlled organization whose equity is publicly traded on the ASX.

6.5.2 Origins and organizational change

GrainCorp began as a New South Wales state government entity originally known as the Grain Elevators Board (GEB), which was established in 1917 to provide a grain handling and storage service for the state's emerging grains industry (Keene, 1998). The GEB was later re-named as the Grain Handling Authority of New South Wales (GHA) in 1981.

In 1989, the New South Wales government began to make legislative changes necessary to allow for GHA's eventual privatization. During the legislative process to privatize the GHA, the government noted its reasons for privatizing the bulk handler:

> There is no justification for the Government's continuing involvement in a commercial operation such as GrainCorp. The recent deregulation of the wheat industry and the resultant increase in competition have only served to highlight the need for GrainCorp to be freed from government ownership. Significantly, the sale of GrainCorp is widely supported by the company, by growers, and by the industry generally (Hannaford, 1992).

Following negotiations with various industry organizations and the unanimous support of the state's major farm organization, the New South Wales Farmers Association, in 1992 the GHA was acquired by New South Wales grain growers through a grower-owned organization known as Prime Wheat Association (PWA). As part of the privatization process, the GHA was re-named as GrainCorp.

GrainCorp's evolution since its privatization has been notable for several reasons, including its mergers with the former BHAs of Victoria and Queensland, and its public listing of equity on the ASX. Since these events have played a significant role in not only GrainCorp's evolution but the industry in general, they are described here.

In 1998, GrainCorp became the first Australian bulk handler and one of only several agribusinesses to publicly list on the ASX. The listing was made possible because of changes made to ASX policy guidelines in 1997, which enabled organizations with cooperative or grower-controlled structures such as GrainCorp's to list one class of equity shares while retaining grower control through another non-listed share class. According to GrainCorp, listing provided an opportunity for all shareholders to have the value of their investment in GrainCorp recognized, and increased the company's expansion opportunities via access to capital (GrainCorp, 1998).

In terms of significant industry mergers, GrainCorp has expanded geographically by merging with the former statutory BHAs of two neighbouring states. The initial steps towards GrainCorp's merger with Victoria's bulk handler began in 1995, when the Victorian government privatized and sold its Grain Elevators Board (GEB) to a consortium consisting of Victorian Grain Services (an unlisted public company owned by Victorian grain growers), GrainCorp, and ABB[116]. At the time of sale, GEB became known as Vicgrain. In late 1999, GrainCorp and Victorian Grain Services agreed to a merger between GrainCorp and Vicgrain. As part of this agreement, the entities' two grower-owned holding companies, PWA and Victorian Grain Services, combined to form one grower-owned organization known as Grain Growers Association Limited (GGA), which would maintain grower control of the merged operating company, GrainCorp. In this capacity, the GGA would help secure growers' role and influence in shaping the development of the grains industry in southeastern Australia (GrainCorp, 1999). The merger between GrainCorp and Vicgrain, which was completed in 2000, represented the Australian grains industry's first major consolidation (GrainCorp, 2001).

[116] In this arrangement, Victorian Grain Services held a 70 per cent ownership share, GrainCorp held a 20 per cent share, and ABB held the remaining 10 per cent. ABB sold its 10 percent ownership stake to Victoria Grain Services in 1999.

In 2003, GrainCorp completed its second major merger, this time with Queensland's traditional bulk handler, Grainco[117]. Similar to the strategies adopted by other former statutory BHAs, Grainco had embarked on a strategy of growth and diversification since its privatization in 1991. Among its diversification efforts was the acquisition of the exclusive export marketing rights for New South Wales sorghum, barley, and canola from the insolvent New South Wales Grains Board (NSWGB) in 2000, as well as the establishment of a joint venture grain marketing arrangement with multinational ConAgra's Australian subsidiary in 2002[118]. In order to raise capital for ongoing growth plans, Grainco was preparing to publicly list on the ASX in 2002[119]. However, an overall downturn in equity markets during this period, along with severe drought, hampered Grainco's efforts to list, and as an alternative it entered into merger discussions with two publicly-listed agribusinesses, GrainCorp and AWB Limited. After considering the two proposals, Grainco decided that GrainCorp's offer was more financially attractive. In recommending the merger to growers, Grainco's board of directors explained that the organization was the smallest, relatively undercapitalized participant in an increasingly competitive industry, and that as a result the merger with GrainCorp was necessary in order to remain competitive and maintain service levels to Queensland growers (Grainco, 2003).

[117] Grainco arose from a 1991 merger between three Queensland statutory marketing boards, two of their associated grower cooperatives, and the state's BHA, Bulk Grains Queensland. Organized as a cooperative in 1991, Grainco converted into an unlisted public company in 1995. Its shares remained fully owned by growers.

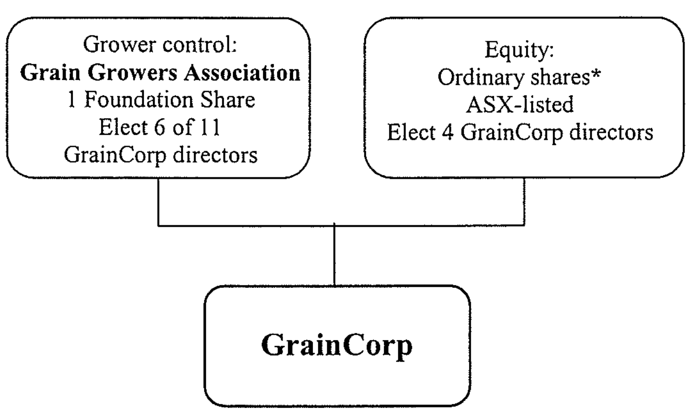
[118] As part of the terms of the merger agreement with GrainCorp, Grainco was required to buy out ConAgra's share of the joint venture arrangement.

[119] As explained by Grainco's chairman, the organization was seeking to list because "if we are going to continue our aggressive strategic growth, then we need to be able to access capital" (Birch, in Bolt 2002e).

In announcing the merger, GrainCorp cited the company's extension of its operations into Grainco's traditional Queensland territory as a means to further diversify its geographic scope and earnings base (GrainCorp, 2003a). The merger increased GrainCorp's substantial position in Australia's east coast grain handling and port facilities. In addition, Grainco's experience in export marketing, gained through its acquisition of the NSWGB's statutory export rights, improved GrainCorp's marketing operations, which prior to the merger had not had significant experience with export marketing. Overall, GrainCorp's merger with Grainco enabled the organization to become a larger, more geographically and earnings-diversified company that could compete more effectively with other national grain industry players, particularly in grain marketing (GrainCorp, 2003b). The merger was completed in 2003.

GrainCorp's current organizational structure, including the role of the holding company GGA, is presented in Figure 6.4.

Figure 6.4 GrainCorp organizational structure



* GGA owned 21% of GrainCorp ordinary shares at September 30, 2003

6.5.3 Organizational structure in 2004

GrainCorp's structure is based on a combination of public ownership and grower control (GrainCorp, 1998). GrainCorp has a single 'Foundation share', as well as an ordinary class of shares. Grower control is maintained through the Foundation Share, which is held by the grower-owned holding company, GGA[120]. The Foundation Share allows the GGA to elect six grower-directors to GrainCorp's 11-member board of directors, including the board's chairman. GrainCorp's ordinary class shareholders elect four directors, and the remaining director is GrainCorp's executive managing director. GrainCorp's constitution requires its shareholders to vote every five years on whether or not the Foundation Share arrangement should be retained[121]. This vote last occurred in 2003, when GrainCorp shareholders voted 92.7 percent in favour of retaining the Foundation Share (Falchoni, 2003).

Public ownership of GrainCorp is achieved through an ordinary class of shares that are publicly listed on the ASX, and can be held by both growers and non-growers. In addition to its holding of the Foundation Share, the GGA has strengthened the extent of grower control of GrainCorp by maintaining a significant holding of its ordinary shares: As of September 30, 2003, GGA owned 21 percent of GrainCorp's ordinary shares, which represented the largest individual shareholding in GrainCorp (GrainCorp, 2003c). According to the GGA, the Foundation Share structure and its substantial direct

[120] The GGA is an association in which lifetime membership is open to eligible growers who pay a nominal membership fee. Voting in GGA is based on one member, one vote (GGA, 2002a). In 2003, GGA represented approximately 17,000 growers (GrainCorp, 2003c).

[121] In order for the Foundation Share to be maintained, at least 75 per cent of the votes cast by GrainCorp shareholders must be in favour of retaining it (GGA, 2002a).

shareholding in GrainCorp allows it to exert considerable grower influence over the latter while allowing GrainCorp access to capital through the equity markets (GGA, 2003a).

6.5.4 Business activities

Through its mergers with Vicgrain and Grainco, GrainCorp has established a dominant presence in storage and handling along Australia's eastern coast[122], and strengthened its position as Australia's largest grain handler in terms of storage capacity. In addition to its core business of storage and handling, GrainCorp has been active in grain marketing since 1995, and significantly strengthened its marketing capabilities through its merger with Grainco in 2003. GrainCorp has also diversified its operations by engaging in various other activities including farm input sales, participation in rail transport through the leasing of rail cars and locomotives, and participation in wheat breeding and commercialization through joint ventures with other industry stakeholders.

GrainCorp undertook further diversification of its business in 2002, when it entered into a partnership[123] with Cargill Australia to purchase the flour milling assets of Goodman Fielder, Australia's largest miller[124]. The purchase, now operating as Allied Mills, was an integral part of GrainCorp's strategy to diversify along the supply chain, and enabled the company to enter the milling sector as a major player (GrainCorp, 2002). Subsequent to the milling joint venture agreement, Cargill Australia and GrainCorp saw an opportunity to achieve greater synergies in their grain accumulation operations, and as

[122] GrainCorp has also expanded its grain handling network into South Australia.
[123] In the partnership, GrainCorp holds a 60 per cent ownership share while Cargill Australia holds the remaining 40 per cent.
[124] AWB Limited also made a bid to purchase Goodman Fielder's milling assets, but was unsuccessful.

a result created a joint venture company in 2003 to combine their grain accumulation functions into one entity, which acts as the buyer of wheat, coarse grains and oilseeds for Cargill Australia, GrainCorp, and Allied Mills (Cargill Australia, 2003).

GrainCorp's diversification into activities such as milling, as well as its geographic expansion through mergers with other bulk handlers, reflects its core strategy, which the organization describes as follows:

> GrainCorp's core strategy is one of earnings diversification involving both vertical and horizontal expansion. GrainCorp's ongoing focus is to mould itself into an integrated agri-food business along the supply chain (GrainCorp, 2003b).

Through this strategy, GrainCorp is positioning itself as a significant rival to the largest Australian agribusiness, AWB Limited. In this respect, some industry observers have speculated that, if the merger between ABB Grain and AusBulk occurs, the merged entity will eventually become a takeover target for GrainCorp, in order to further increase its ability to compete globally (Clegg, 2004b).

6.6 Co-operative Bulk Handling Limited

6.6.1 Introduction

Co-operative Bulk Handling Limited (CBH) is Western Australia's traditional bulk handling organization. Although CBH has remained primarily focused on maintaining a dominant position in Western Australia's bulk handling sector, it has made recent efforts to diversify its activities, in particular grain marketing by merging with the state's single desk export marketer of barley, lupins, and canola, and by forming a joint venture with a major participant in the Asian food market. After a failed attempt to undertake a corporate restructuring in 2000, CBH remains organized as a cooperative fully-owned and controlled by Western Australian grain growers.

6.6.2 Origins and organizational change

CBH originated in 1933, when the Westralian Farmers' Co-operative joined with the Western Australian Wheat Pool to create the organization. Similar to the objectives of other states' traditional bulk handlers, the primary purpose of CBH was to develop Western Australia's bulk handling system (Whitwell and Sydenham, 1991).

Similar to their counterparts in the eastern states, in the 1990s CBH's board and management recognized that significant changes were occurring in the industry, and that many organizations were diversifying in order to prepare for the possibility of a fully deregulated industry. However, CBH was relatively slower in initiating change: Such was the diversification efforts by other states' bulk handlers that, by the year 2000, CBH found itself as the only traditional bulk handler in Australia that was still focused exclusively on storage and handling activities (Watson, 2000). CBH became increasingly concerned about its position in the industry, in particular the possibility that major competitors would begin to enter its traditional Western Australian market. CBH's chief executive officer has described the organization's strategic thinking in the late 1990s as follows:

> For a long time we had been an inward-looking company, insulated from external influences by government regulations. But through the 90s we began to feel the pressures of major players in the Australian grain industry re-positioning themselves in the market. In the light of the potential for Eastern States' businesses to make inroads into our storage and handling role we had two choices. One was to circle the wagons and fight off the Indians from the East. And initially, in that early part of the 1990s, CBH did, indeed, remain inward-looking and limited, with a concentration on receival points, sampling and specifications. The other choice was to expand and improve our range of services. To corporatise. To diversify. To merge with other players along the grain chain. We had no choice but to change and improve (Mencshelyi, 2003b).

In light of the changes occurring in the industry, CBH's board of directors and management questioned whether its traditional cooperative structure was the most appropriate to prepare it for future challenges. Citing the need to adapt in order to prepare for an increasingly competitive environment, CBH presented a corporate restructuring proposal to its members in 2000, which would have transformed the cooperative into a dual class share corporate model. However, after a lengthy debate on restructuring, a vote held among CBH's members did not reach the 75 per cent support level required to accept the proposal. Feedback from growers indicated they were unconvinced that the timing was right for the organization to embark on a path of corporate change (CBH, 2000b). CBH's chief executive officer has commented that the failure by growers to accept the restructure was due mainly to their reluctance for change and their fears of losing control of their cooperative[125] (Mencshelyi, 2003a).

Even though it did not receive approval for a corporate restructuring, CBH's board and management felt that ongoing consolidation in the industry would challenge the organization and it would have to act in order to maintain a position of strength in Western Australia. As a result, in 2001 CBH entered into a merger agreement with the

[125] Fear of losing grower control existed despite the fact that the proposed dual class model was designed to retain grower control through a class of non-tradable shares that would have been issued solely to growers (CBH, 2000a).

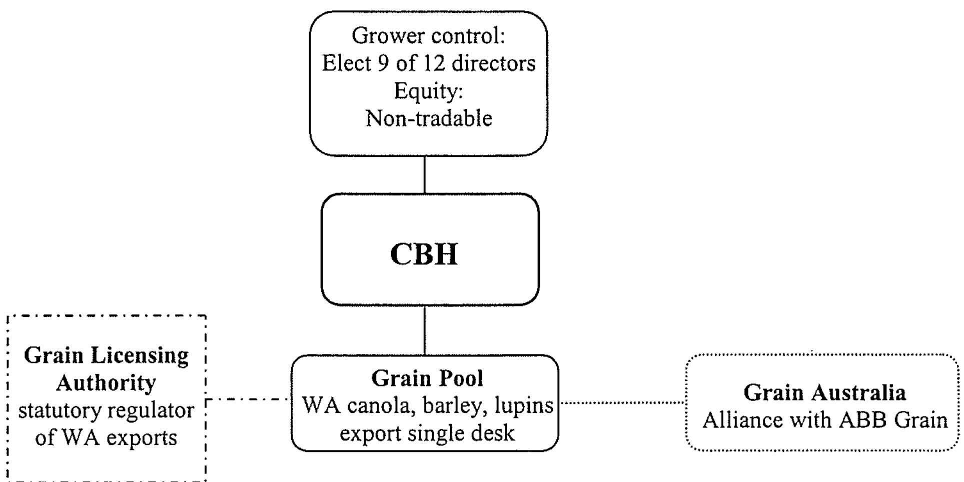
Grain Pool of Western Australia (Grain Pool of WA), the state's statutory export marketer of barley, lupins, and canola. The merger was driven by a need to create a stronger state-based industry, one that would ensure CBH's grower-members continued to control the future of the state's industry (CBH, 2002a). Moreover, the merger would extend CBH's activities beyond storage and handling into grain marketing. A key feature of the proposed merger was that there would be no change to the CBH cooperative structure (CBH, 2001). In order for the merger to proceed, it required approval from CBH's members. CBH and the Grain Pool of WA undertook an extensive communication effort which involved over 80 presentations to inform growers about the proposed merger. CBH members subsequently approved the merger by casting their votes 85.1 per cent in favour. According to CBH's chairman, the results of the vote demonstrated that Western Australian growers were now conducive to change, in contrast to the sentiments expressed during the past restructuring proposal:

> Following our bid to restructure CBH in 2000, we have been waiting for the industry to arrive at some consensus, in order to move forward as a strong and united force. Today's [voting] results indicate that growers now recognize the need to prepare for the future. It was our task to produce a formula that would deliver a merged organization that strengthens the local industry, retains the CBH cooperative structure and ensures that growers control its future destiny. In the merger proposal we did this and growers have responded with their support (Watson, 2002).

Because the Grain Pool of WA was a statutory marketing authority, the merger required changes to state legislation to take effect. Accordingly, the Western Australian government passed legislation in 2002 that separated the regulatory and commercial functions that had previously co-existed in the statutory Grain Pool of WA. An independent statutory authority—the Grain Licensing Authority (GLA)—was established to assume regulatory responsibility for controlling exports of Western Australian barley, lupins, and canola. At the same time, the Grain Pool of WA was privatized and established as a wholly-owned subsidiary of CBH, known as Grain Pool Pty Ltd (Grain Pool), to assume the commercial functions of managing the export single desk[126]. In addition to its single desk activities, Grain Pool also has a wholly-owned subsidiary, AgraCorp Pty Ltd, that trades in other grains, including chickpeas, oats, and wheat.

CBH's organizational structure, as well as the role of the statutory GLA, are outlined in Figure 6.5. The figure also depicts Grain Australia, an export marketing alliance between Grain Pool and ABB Grain.

Figure 6.5 CBH organizational structure and the statutory GLA



6.6.3 Organizational structure in 2004

CBH is a cooperative organization owned and controlled by approximately 7,500 members who are active Western Australian grain growers. Voting rights are based on

[126] In order to operate the single desk, Grain Pool is granted a 'main export license' by the GLA, which enables it to export bulk barley, canola and lupins without the GLA's prior permission. The GLA also has the power to grant 'special export licenses' to an entity other than Grain Pool, if it believes the granting of the license would not affect any single desk premiums earned by Grain Pool in that particular market.

the principle of one member, one vote. The organization's board of directors consists of nine elected directors who must be active growers, and three appointed directors, the latter of whom are appointed by the board for their specific skills or expertise. CBH does not distribute any surplus or profits to its members. Instead, profits are retained in the business, in order to provide capital for its future endeavours.

6.6.4 Business activities

CBH is primarily involved in the storage and handling of grain in Western Australia and, as a result of its merger with Grain Pool of WA, the marketing of grain.[127] In addition to grain marketing, CBH has also diversified into engineering and construction of bulk handling infrastructure and equipment through a wholly-owned subsidiary, Bulkwest. As with its diversification into marketing, the purpose of establishing Bulkwest was to provide CBH with alternative income streams to storage and handling, in order to reduce the organization's dependence on storage and handling charges as a primary source of income, and lessen its exposure to problems associated with drought seasons in Western Australia. In this context, Bulkwest has completed construction projects for clients along Australia's eastern seaboard (CBH, 2002a).

In addition to grain marketing, engineering, and construction services, CBH has more recently expanded into grain processing: In 2003, CBH announced it had entered into a joint venture agreement with George Weston Foods to establish a lupin de-hulling plant

[127] As mentioned in the case study of ABB Grain, CBH's marketing subsidiary, Grain Pool, is part of a strategic marketing alliance for bulk barley exports with ABB Grain. Known as Grain Australia, this strategic alliance is one of the world's major providers of malting barley, supplying over 40 per cent of the world's malting barley as well as 10 per cent of its feed barley (Reading, 2003).

in Western Australia (CBH, 2003). More recently, CBH has sought further linkages with other downstream participants in the value chain: In 2004, CBH formed a joint venture company with the Salim Group, a major participant in the Asian food market, including a leading market position in Indonesia's flour milling and noodle making industries[128]. The joint venture also included a 4.85 per cent ownership stake in Futuris, a major rival to AWB Limited's Landmark. According to CBH, the joint venture provides a platform for investment in the agricultural supply chain both in the Australian and Asian regions, and provides an opportunity for CBH, the Salim Group, and Futuris to work together on various supply chain initiatives (CBH, 2004).

In recent years, a particularly contentious issue for CBH was the potential for AWB Limited to enter the Western Australian storage and handling sector, as it had done in the eastern states, and therefore become a direct competitor. CBH estimated that any such move by AWB Limited would have eroded the organization's value by $252 million (CBH, 2002b). Although AWB Limited indicated that its preferred approach in terms of Western Australian supply chain integration was to partner with CBH in some manner, the two entities were unable to reach an agreement for several years. At times the issue was particularly acrimonious, and resulted in CBH making an aggressive proposal in 2002 to take over single desk export wheat pool management services for AWBI in Western Australia, free of charge from AWB Limited. The two organizations eventually reached an agreement in 2003 to form a joint venture to unify their grain logistics

[128] The Salim Group also happens to be one of AWB Limited's largest customers (West Australian, 2004).

activities in Western Australia[129]. The purpose of the joint venture will be to reduce grain logistics costs for the benefit of all grain growers and the broader agricultural industry. The joint venture will not change the cooperative structure of CBH or transfer ownership of CBH's assets (AWB Limited, 2003e).

CBH's joint venture arrangement with AWB Limited, its entry into grain marketing and processing, and its joint venture with the Salim Group, including a small ownership stake in Futuris, signal that the organization is seeking further integration along the value chain. Reflecting this strategy, CBH's chairman has summarized the general shift in approach that has occurred among all of Australia's traditional bulk handlers:

> Until now most of us have invested solely in one part of the value chain—the supply end—where...there is very little value to share amongst many participants...Will we continue to navel gaze and see capital investment as more and bigger and faster storages and facilities to transport raw product? Or will we seize the opportunity to invest further along the value chain and develop those critical trade relationships that will enable Australian growers to share in the wealth created from the farm gate to the consumer's plate? (Watson, 2004).

More specifically, CBH's chairman pointed out recent strategic acquisitions of its competitors – AWB Limited's purchase of Landmark, AusBulk's malting acquisitions, and GrainCorp's milling acquisition with Cargill Australia– and noted that "each of these companies has recognized that by moving up the value chain, they can return value to their grower shareholders". Although involvement in business activities along the value chain can create additional value and returns for growers, CBH's chairman stated that "unfortunately for CBH and Western Australian growers, we could not go as far as paying dividends to our growers under our existing structure, but for growers throughout the rest of Australia, this is certainly a likely outcome" (Watson, 2004). Comments such

[129] Establishment of the joint venture is contingent on approval from the Australian Competition and Consumer Commission.

as these would seem to suggest that another proposal to restructure CBH's traditional cooperative arrangement is likely to occur, in order to create a mechanism that enables Western Australian growers to directly benefit from the organization's increased involvement along the value chain.

6.7 Summary

The case studies presented in this chapter reveal that, since deregulation began in 1989, all five Australian entities have sought further diversification and growth along the value chain, through mechanisms that include mergers, acquisitions, and joint ventures or alliances. With the exception of CBH, these organizations have adopted corporate structures that retain grower control yet establish tradable equity shares that can be held by growers and non-growers alike. In addition, these organizations have sought to publicly list such equity on the ASX, Australia's major national stock exchange. In contrast, CBH has retained a traditional cooperative structure, in which the organization is exclusively grower-controlled and grower-owned, and equity is non-tradable. Although they are all private (i.e. non-government owned) entities, AWB Limited, CBH, and ABB Grain have maintained exclusive marketing rights granted by federal or state governments, and have therefore established wholly-owned subsidiaries that are responsible for undertaking these single desk pooling functions on behalf of growers. The most significant of these exclusive rights is AWB Limited's single desk export marketing arrangements for bulk Australian wheat.

Chapter 7 Analysis

7.1 Introduction

The preceding chapters presented an overview of the Australian grains industry and the evolution of five major Australian agribusinesses within this environment. These five agribusinesses began as marketing and handling organizations with exclusive government-granted privileges, which functioned in a manner similar to compulsory agricultural cooperatives. Since deregulation began in 1989, these organizations have undergone structural changes that have altered their traditional cooperative nature to varying degrees. As described in chapter five, structural change among traditional cooperative organizations has been studied by various researchers from the perspective of NIE. Within this field of study, cooperative life cycle theory has emerged. This chapter analyzes the evolution of the Australian organizations from the perspective of cooperative life cycle theory, in order to determine whether the issues underlying their evolution are similar to those suggested by the theory.

7.2 Cooperative life cycle theory applied to the Australian experience

The remaining portion of this chapter is structured according to Cook's (1995) cooperative life cycle model, as described in chapter five. Within this five-stage framework, the evolution of the Australian organizations is analyzed. Table 7.1 presents an overview of the cooperative life cycle model applied to the Australian experience, including approximate timelines that indicate when each stage occurred.

Table 7.1 The cooperative life cycle model applied to the Australian experience

Stage One	Stage Two	Stage Three	Stage Four	Stage Five
1920s to 1950s Instability and insecurity associated with the Depression and wartime conditions contribute to grower apprehension of the open market and fear of grower exploitation by middlemen and processors. 'Compulsory cooperative' statutory marketing arrangements consequently introduced. Statutory bulk handling arrangements introduced to foster successful development of state bulk handling infrastructure. Statutory arrangements reflect cooperative principles of grower control and benefits distributed according to grower use of the business.	1950s to 1970s Statutory arrangements remain in place for a significant period of time because of perceived grower benefits associated with system. Continuing fear that grower exploitation would occur if exclusive marketing and handling rights removed.	1970s and 1980s Increasing concern among government and some farm leaders about costs and efficiency of industry arrangements. 'Economic rationalism' and microeconomic reform dominate Australian policymaking: Inquiries such as the IAC reviews and the Royal Commission into Grain Handling, Storage and Transport increase public scrutiny of industry costs and efficiency. Prominent farm leaders criticize industry arrangements. Domestic deregulation implemented in 1989; significant structural changes introduced to Australia's flagship statutory marketing authority, AWB. Organizations contemplate changes needed to remain competitive in deregulatory environment: Primary concerns involve capital accumulation and appreciation, and grower access to equity; and grower control of organization.	1990s Australia's adoption of competition policy reforms in 1990s signals further deregulatory changes. Organizations undertake strategic planning processes to consider alternatives in an increasingly competitive environment. Planning process involves consultations with growers; professional legal and financial advice; and government involvement where necessary.	1990s onward Organizations undertake strategies of growth and diversification along the supply chain. Organizations implement chosen structural alternatives: AWB Limited and ABB Grain implement dual class share structures; GrainCorp and AusBulk implement holding company structures; CBH maintains traditional cooperative structure after growers reject dual class share restructuring proposal. In all five organizations, grower control is maintained. In all cases except CBH, public listing of equity is sought. Further deregulation and industry rationalization are expected to occur.

7.2.1 Stage one

In stage one of the life cycle, a cooperative is formed as a collective grower response to market failure. The primary reasons for establishing the Australian statutory marketing and handling entities in the early 20th century appear to be consistent with this rationale for cooperative formation. As explained in chapter three, a major objective behind the formation of Australia's statutory marketing authorities was to establish grower control of marketing in order to avoid exploitation by middlemen and processors. Furthermore, the experience of both the Depression and wartime conditions had a significant effect on growers' attitudes towards the open market[130]. Under these conditions, many growers embraced statutory arrangements as a means to provide some degree of stability and control to their industry (Productivity Commission, 2000a and 2000b; Reeves and Cottingham, 1994). Orderly marketing arrangements through 'compulsory cooperatives' such as AWB and ABB were part of this approach.

The primary reason for establishing statutory bulk handling entities also appears to be consistent with stage one's rationale for cooperative formation. As explained in chapter three, the economies of size and capital required to construct and operate bulk handling facilities was substantial. Fearing that Australia's bulk handling system would not become economically viable if use of these facilities by growers remained voluntary, each state government introduced statutory arrangements to foster the development of its bulk

[130] As Whitwell and Sydenham (1991) explain, "The unregulated market economy was judged an inherently faulty system. Purposive state action was deemed essential for the operation of a more efficient, more productive, more equitable and more secure economic system" (62).

handling infrastructure[131]. In this manner, the organizations now known as AusBulk, GrainCorp, and CBH were able to establish themselves as viable economic entities.

7.2.2 Stage two

A factor that somewhat complicates a direct correlation to stage two of Cook's (1995) life cycle is the extensive regulatory features that blanketed the Australian industry until 1989. Whereas Cook's stage two describes the period subsequent to cooperative formation during which the cooperative provides services or products on more favourable terms than the existing IOF oligopoly, statutory powers granted to grower-controlled marketing and bulk handling authorities effectively removed competition in the Australian grains industry altogether, at least for the major grains such as wheat and barley. As such, no direct comparison between the 'compulsory cooperative' activities of the statutory entities and the activities of private sector competitors was possible, as the latter were precluded from competing in the marketplace.

However, the regulated exclusion of competition does not necessarily imply that Cook's stage two is inapplicable to the Australian experience. Rather, it can be argued that Australia's statutory marketing and handling arrangements remained virtually unchanged for a prolonged period of time because growers perceived benefits arising from these arrangements. In many years, for example, the wheat marketing scheme's system of administered domestic pricing and government-guaranteed stabilization

[131] Whitwell (1993b) also notes that, from a political standpoint, individual states demanded exclusive monopoly rights over handling and transportation as quid pro quo for the passage of complementary state legislation required to implement AWB's compulsory powers, which was necessary as a result of Australia's federal-state constitutional arrangements.

arrangements, facilitated through the AWB, operated to the clear benefit of growers, albeit at the expense of domestic consumers and taxpayers. Because the benefits provided to growers through these statutory arrangements were not as visible to the public as direct methods such as outright subsidies would have been, they did not attract significant critical attention[132]. Moreover, this period coincided with generally prosperous conditions for grain, which made it difficult for any critics to argue that the statutory arrangements were not beneficial to the industry (Whitwell, 1993b).

During this period, growers continued to have a general distrust of market forces, and the longevity of the statutory arrangements partly reflected growers' ongoing fear that oligopolistic power would otherwise emerge. For example, Wait and Ahmadi-Esfahani (1996) contend that Australia's wheat marketing arrangements remained relatively unchanged from 1948 to 1989 because "there was a great fear that a competitive marketing environment would lead to exploitation of growers. This was due to the belief that private sector monopolies in the handling and purchasing of wheat would emerge" (318). In light of this apprehension, growers were generally content during this period with statutory marketing and handling arrangements that maintained their control of the relevant organizations.

[132] In this regard, Whitwell (1993b) notes: "The scheme lasted so long, the economists argued, precisely because its effects were largely hidden from public view and because consumer opposition, it if existed, was weak and diffuse" (33).

A significant point to note about the longstanding period of statutory arrangements in Australia was that its primary emphasis was on grower equity[133]. This period represented a commitment to orderly marketing, a concept which embodied the ideals of grower equality, the sharing of risks, and the stabilization of prices. Compulsory pooling of revenues and costs was a method used to ensure grower equality and to spread risks among growers collectively[134] (Whitwell, 1993b). Eventually, a general shift in emphasis occurred in Australia, as concerns about the efficiency of these statutory arrangements became more prominent. As this occurred, stage three began.

7.2.3 Stage three

According to Cook (1995), in stage three of the life cycle, a cooperative's net benefits become less distinguishable, and the focus turns towards scrutinizing costs more closely. In the Australian grains industry, it would appear that a similar focus on costs and efficiency became prevalent in the 1970s and 1980s, and these concerns ultimately led to significant industry changes beginning in 1989. As this occurred, Australia's marketing and handling organizations had to consider how they could remain viable in an increasingly competitive environment. Viewed from this perspective, it would appear that the Australian grains industry experienced stage three of the life cycle in two distinct ways: First, a general concern among government and some growers emerged about the industry's costs and efficiency, which led to increased public scrutiny and debate about the statutory arrangements. This process ultimately led to deregulatory changes

[133] In this respect, equity has been described as relating to "an equal opportunity for all growers, regardless of their proximity to a domestic market outlet, to share in the returns from both export and domestic sales, and to the responsibility of all growers to contribute to industry storage and handling, freight, research, administration and other costs" (Whitwell and Sydenham, 1991: 290).
[134] The government also participated in risk sharing through financial guarantees provided to the statutory entities.

beginning in 1989. Second, given this deregulatory push, Australia's marketing and handling organizations had to consider how they could remain competitive in the future, and any changes that would be needed in order to do so.

In terms of the general focus on costs and efficiency, factors that arose during the 1970s and 1980s reflected a greater concern with the industry's costs and efficiency than had previously existed. Ultimately, the combination of these factors contributed to a fundamental shift towards deregulation. At the broadest level, the emphasis on 'economic rationalism' by Australian policymakers during this period had at its core a goal of greater economic efficiency. In this policymaking environment, the Australian grains industry underwent greater public scrutiny through mechanisms such as the IAC and the Royal Commission[135]. The work of these bodies facilitated greater public debate about the benefits and costs of the industry's statutory arrangements and led to criticism about their effects on efficiency[136]. Consistent with what the results of these public inquiries seemed to suggest, Martin (1990) contends that by the 1980s, the net benefits to growers arising from the statutory arrangements had probably diminished over time, and that wheat marketing regulations in particular appeared to have outlived their usefulness to their primary beneficiaries, Australian wheat growers.

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[135] Furthermore, the 1980s represented a period of low returns to producers, which also contributed to an increased focus on industry costs (Martin, 1990). The GCA has noted similar concerns that arose during this unprofitable period. In particular, it contends that in the late 1980s, low commodity prices, high costs and declining farm capital contributed to the belief that the industry would not be sustainable if substantial changes did not occur (GCA).

[136] Wait and Ahmadi-Esfahani (1996) contend that by the 1980s, it was recognized that charges related to wheat marketing were excessive, and that studies such as those conducted by the IAC and Royal Commission "had the common theme that efficiency of wheat marketing could be improved by a move toward a market orientated system" (318).

Criticism about the industry's costs and efficiency during this period came not only from government, but also from a small but prominent contingent of growers. As described in chapter four, influential AWF executives such as Trevor Flugge were increasingly critical about the industry during this period. Among their concerns was that the statutory bulk handling arrangements, rather than protecting growers, had encouraged inefficiencies that resulted in smaller net returns. Flugge argued that any benefits derived from the organizations' statutory powers were flowing to the organizations themselves and their management, not to growers[137] (Whitwell and Sydenham, 1991).

In light of these concerns, a major turning point for the industry was the passage of legislation in 1989 that, among other things, removed AWB's domestic monopoly and bulk handlers' sole receival rights. The legislation also implemented major changes that enabled AWB to engage in a broader range of activities. Moreover, AWB would eventually be backed by a sizeable capital base funded entirely by growers. Essentially, the 1989 legislation established a framework for AWB to morph into an organization vastly different from its statutory beginnings and, given its size and status as the single desk export marketer of Australian wheat, would undoubtedly have an impact on other organizations in the industry.

More generally, the mix of changes embodied in the 1989 legislation, along with formal government commitment to NCP reforms in the 1990s, signaled a new era for Australia's grain marketing and handling organizations, one in which they would be

[137] Similar concerns about the efficiency and 'featherbedding' of statutory bulk handling and transportation arrangements during this period have been noted by Martin (1990) and A.S. Watson (1999).

increasingly exposed to competitive market forces. Faced with this reality, these organizations, along with the growers they represented, considered the strategies needed to remain viable in a markedly different operating environment. As the case studies demonstrated, these entities have chosen strategies of growth and diversification in some manner, primarily by geographic expansion and entering new business segments.

As part of their strategic planning processes, the Australian organizations had to consider whether they were appropriately structured to pursue such endeavours. In this process, two common themes emerged: concerns about maintaining grower control of the organization; and attaining sufficient financial flexibility in a manner that would also enable growers to access accumulated equity at an appropriate value. These issues can be viewed in the context of the five vaguely-defined property rights problems identified by Cook (1995). The free rider, horizon, and portfolio problems all relate to the difficulties cooperative organizations have in accumulating capital, and to the difficulty growers have in accessing and managing their cooperative equity in a manner that recognizes the value of that equity. These capital issues become particularly problematic when the organization wants to grow and diversify its operations, as substantial levels of capital are often required to finance such endeavours. The control and influence costs problems focus primarily on organizational control issues and the relationship between an organization's owners and management. In all five organizations examined, growers were concerned about losing control of the entity to non-grower interests. Section 7.3 will consider the extent to which the current organizational structures of the five entities address vaguely-defined property rights problems.

7.2.4 Stage four

In stage four of the life cycle, the organization's decision-makers become increasingly aware of the property rights problems associated with its traditional structure and the difficulties they can create in managing the business into the future. As such, the organization must consider its goals for the future, the benefits of its cooperative nature, and any problems that may need to be addressed so that there is no discord between the two. As a consequence, various structural alternatives are considered. As the case studies demonstrated, the Australian entities underwent similar processes in which the organization's leaders considered how the entity should be structured for the future. This involved extensive consultations with the organization's growers and the advice of financial and legal experts. In the cases where privatization was required to formally transfer ownership of the statutory authority to growers (which occurred with AWB Limited, ABB Grain, and GrainCorp), government involvement was also necessary.

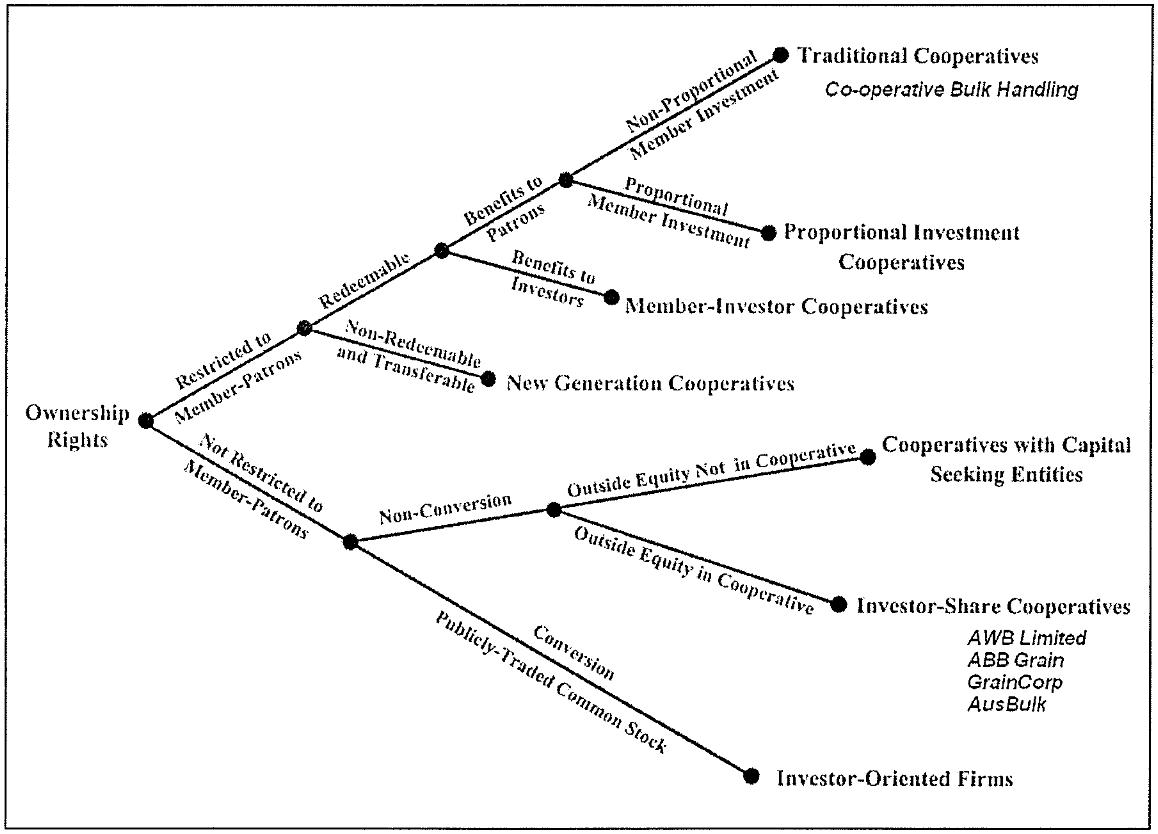
Given the importance it has played in the nation's grains sector, it is not surprising that AWB underwent the most extensive restructuring process among the five organizations studied. Beginning with legislative changes and the GCA's organization of the 'Grains 2000' strategic planning process in 1989, almost a decade of consultations among AWB, growers, government, and other industry stakeholders occurred until the organization was formally privatized as a dual class share corporation July 1, 1999. The planning process involved an assessment of what the future industry environment would look like in terms of both domestic and international competitive pressures, identifying what growers wanted AWB to achieve within this environment, and considering what sort of organizational structure could best carry out those objectives. While the process may not have been as extensive as that undertaken for AWB, similar approaches appear to have been followed by ABB and GrainCorp in terms of achieving privatization. Because of their legal status as cooperatives rather than statutory entities, AusBulk and CBH differed from the experiences of AWB Limited, ABB Grain, and GrainCorp in the sense that they did not have to directly involve government in a privatization effort. In other respects, however, the process of considering organizational change was similar for all five Australian entities, in particular the important role that growers played in determining the direction and extent of organizational change.

Although their planning processes may have been similar, the structural alternatives ultimately chosen by the five Australian organizations were not identical. The chosen alternatives are the focus of stage five.

7.2.5 Stage five

A cooperative reaches stage five of the life cycle once a decision to implement a chosen strategic alternative occurs. In this respect, Cook (1995) identifies three general alternatives: exiting (for example, by converting into an IOF structure or merging with another entity); continuing in some modified cooperative form; or shifting into an NGC type of structure. As described in chapter five and indicated in Figure 5.1, Chaddad and Cook (2002, 2003) have elaborated on this subject by identifying a range of innovative organizational forms that agricultural cooperatives have adopted in recent years. These organizational forms range from the traditional cooperative model at one end of the spectrum, to full conversion to an IOF structure at the other. As presented in Figure 7.1, the five Australian organizations can be viewed within the context of this typology.

Figure 7.1 Australia's agribusinesses in the typology of alternative cooperative forms



Adapted from Chaddad and Cook (2002)

The structures adopted by AWB Limited, ABB Grain, AusBulk, and GrainCorp fall within Chaddad and Cook's (2002, 2003) investor-share cooperative category, whereas CBH resembles the traditional cooperative model. From the perspective of Cook's (1995) exit, continue, or shifting alternatives, all five Australian entities have chosen the alternative of 'continuing' in some form, with CBH taking the most conservative approach in terms of maintaining traditional cooperative features[138].

[138] In contrast to these five entities, it is interesting to note that two of Australia's other former statutory organizations—Grainco and VicGrain—chose Cook's (1995) 'exit' alternative by merging with a larger entity, GrainCorp. These mergers were described in the chapter six case study of GrainCorp.

As explained in chapter five, Chaddad and Cook's (2002, 2003) investor-share cooperative category involves organizational forms that source equity capital from non-users, such that ownership rights are no longer restricted to patrons of the business, i.e. growers. Moreover, these structures attempt to separate the role of investor and user, such that a grower's decisions to use and invest in the business are no longer linked. AWB Limited, ABB Grain, GrainCorp and AusBulk represent such organizational forms. More specifically, the dual class share structures adopted by AWB Limited and ABB Grain, and the holding company models utilized by GrainCorp and AusBulk, all have characteristics that resemble the investor-share cooperative category[139].

In the dual class share structures of AWB Limited and ABB Grain, grower control is maintained through one class of voting shares, while risk capital is accumulated through another class that can be held by any investor, regardless of grower status. Although this latter class also carries voting rights, they are minor in relation to those allotted to the exclusive grower 'control' shares. Through their dual class share structures, AWB Limited and ABB Grain have attempted to maintain grower control of the organization while simultaneously accessing the level of capital needed to finance strategies of growth and diversification, and rewarding investors accordingly for the risk capital they have provided for this purpose. Although GrainCorp and AusBulk have adopted holding company models rather than dual class share structures, the general purpose of these structures is similar: They maintain grower control while simultaneously enabling the organization to access sources of risk capital to finance

[139] Chaddad and Cook (2002) themselves refer to AWB Limited as an example of an investor-share cooperative, and note the popularity of such organizational arrangements in Australia.

strategies of growth and diversification, and providing growers with the opportunity to adjust their individual equity holdings through tradable stock. As with AWB Limited and ABB Grain, potential investors of AusBulk and GrainCorp are not restricted to growers.

In terms of capital sourcing, a feature common to all four organizations is their decision to list equity shares on a public stock exchange, namely the ASX[140]. Listing was made possible after rule changes to the ASX in 1997 allowed grower-controlled entities to publicly list a separate class of equity shares, thus enabling the formal separation of organizational control and equity ownership. Listing represents an expressed desire by these organizations to have access to increased capital through the share market, as well as a means for growers to access the full value of their equity (Brindal, 2002). In many respects, the equity shares of these organizations resemble the common stock of an IOF, but without the full residual control rights typically attached to the latter. Grower control reflects an ongoing commitment to a key cooperative principle that distinguishes these Australian entities from IOFs. In this context, AWB Limited, ABB Grain, AusBulk, and GrainCorp all represent examples of Sykuta and Cook's (2001) definition of a producer-oriented firm, as their organizational structures all maintain a cooperative orientation towards serving the interests of the grower.

In contrast to the investor-share cooperative structures adopted by AWB Limited, ABB Grain, GrainCorp, and AusBulk, CBH has maintained a traditional cooperative arrangement, in which equity is non-tradable and non-appreciable, and is sourced from

[140] GrainCorp, AWB Limited and ABB Grain have already listed shares on the ASX. AusBulk noted its intention to do so in 2004, prior to reaching a merger agreement with ABB Grain.

growers only. As such, CBH is located in the uppermost branch of the typology presented in Figure 7.1. It would appear that the primary reason for CBH's adherence to a traditional cooperative model is Western Australian growers' collective apprehension that any alternate structure would weaken the organization's cooperative values, including the potential loss of grower control. CBH's traditional cooperative structure has been maintained, even though its board and management advocated for a corporate restructuring that would have transformed the entity into a dual class share model. The disapproval of CBH's growers relative to the restructuring decisions endorsed by growers in the other four Australian entities raises an interesting point that Royer (1992) makes, and which Chaddad and Cook (2002) stress must remembered in any cooperative restructuring: That the decision of which organizational form to choose will ultimately depend on the fundamental orientation of the organization's growers.

7.3 Vaguely-defined property rights problems and Australia's current organizational structures

A relevant question to consider in terms of cooperative life cycle theory is whether Australia's current organizational arrangements have the potential to mitigate the five vaguely-defined property rights problems (i.e. the free rider, horizon, portfolio, control, and influence costs problems). For the purposes of answering this question, the four Australian organizations that have adopted investor share-cooperative structures (namely AWB Limited, ABB Grain, GrainCorp, and AusBulk) are evaluated as one group, and the organization that has retained a traditional cooperative structure—CBH—is evaluated as another. Table 7.2 presents an overview of the potential for these two groups to address the five vaguely-defined property rights problems.

Table 7.2 Australia's organizational structures and their potential effect on vaguely-defined property rights problems

	Investor-share cooperative models with tradable and appreciable equity rights *AWB Limited* *ABB Grain* *GrainCorp* *AusBulk*	**Traditional cooperative structure with non-tradable equity rights restricted to grower-members** *CBH*
Free rider problem	Reduced; Internal free rider problem reduced because equity rights are no longer linked to grower use; therefore grower use of the business does not dilute existing equity. Negligible impact on external free rider problem.	No change
Portfolio problem	Reduced; Tradable shares enable growers to adjust individual equity holdings to match personal risk preferences; Secondary market for shares such as ASX facilitates specialization of risk bearing among individuals.	No change
Horizon problem	Reduced; Tradable share price reflects investors' assessment of net present value of organization's earning potential; As equity rights are no longer linked to grower use, growers do not have to match duration of patronage with duration of specific organizational project payoffs. Reduced incentive for growers to pressure management to favour projects with short payoff horizons.	No change
Control problem	Mixed; Public listing of shares provides increased information reporting that facilitates greater monitoring of managerial performance; investors can signal their dissatisfaction by selling the company's stock; *But:* Hybrid grower-investor ownership structure may lead to conflicting objectives between these two groups: whose interests take priority for the organization? Growers as users of the business (i.e. maximize grower returns), or investors (i.e. maximize shareholder wealth)?	No change
Influence costs problem	Increased; Perceived conflicts of interest between growers and investors in hybrid grower-investor ownership structures. The granting of single desk rights to some entities has exacerbated industry tensions. Organizational resources must be dedicated to addressing perceived conflicts and stakeholder complaints.	No change

7.3.1 The traditional cooperative structure: CBH

As indicated in Table 7.2, CBH is unique in that its potential to address the five vaguely-defined property rights problems is unaffected, since it has maintained a traditional cooperative structure. Equity is non-tradable, and the organization's articles of association prohibit the distribution of any surplus or profits to members. Although CBH has accumulated a significant level of capital by retaining earnings in the business, under its current structure CBH members do not have any means by which to access this equity. Horizon and portfolio problems may increasingly arise in today's competitive environment if CBH increases its capital utilization to pursue more aggressive strategies of growth and diversification, but members want a greater degree of liquidity and access to this capital, at values that reflect the underlying investment potential of CBH. Moreover, CBH may encounter free rider problems if significant competition enters the Western Australian storage and handling sector, or if Grain Pool loses its export single desk marketing privileges. If either of these scenarios occurs, Western Australian growers will have greater choices of service providers, and CBH may therefore experience reduced use of its services. In the recent past AWB Limited represented a legitimate threat of entry as a significant competitor to the Western Australian storage and handling sector. Faced with this threat and the possible dilution of organizational value it would evoke, CBH's preference was to establish a partnership arrangement with AWB Limited, which occurred in 2003.

In terms of the control problem, because CBH equity is not publicly traded, the organization's management is not exposed to external monitoring pressures that typically accompany publicly-traded stock. As such, the organization may experience increased agency costs associated with the control problem. In terms of the influence costs problem, growers who are not satisfied with CBH's performance have no means by which they can exit the organization by selling their equity holding. Instead, their only means of expressing their dissatisfaction is through their votes and the elected directors. Furthermore, the fact that CBH profits are retained in the business and not distributed to members implies that growers only receive benefits when they actually use the cooperative's products and services. As such, members may have an increased incentive to ensure that CBH's mix of products and services serves their individual needs as growers. As a result, growers located in different areas and with different business needs may pressure CBH's management to undertake activities that serve their particular farm interests, even if these activities may not be beneficial to the cooperative's overall performance. Although these property rights problems may be somewhat mitigated by the fact that CBH has remained primarily focused on its traditional geographic region (Western Australia) and therefore its members may have relatively homogeneous interests compared to those in more geographically-diversified organizations, this may change as CBH engages in a greater range of activities in various geographic markets.

In recent years CBH has pursued an increasingly aggressive strategy of integration along the supply chain. If capital requirements for these endeavours increase, and if members express a desire to access the organization's substantial level of accumulated equity, then there may come a time in the not too distant future when members will again be asked to consider changes to CBH's traditional cooperative structure. In this respect, CBH members may be more conducive to accepting organizational change than they were in the past. Since the failed corporate restructuring proposal in 2000, members have endorsed mechanisms that accelerate the organization's growth and diversification: the approved merger with Grain Pool of WA, the joint venture agreement in grain logistics with AWB Limited, and the joint venture with the Salim Group facilitate CBH's integration along the value chain and strengthen its competitive position in its core business of grain storage and handling. Grower endorsement of these activities may signal a greater willingness to accept organizational change[141].

7.3.2 Investor-share cooperative structures: AWB Limited, ABB Grain, GrainCorp and AusBulk

In contrast to the traditional cooperative structure of CBH, the investor-share cooperative structures adopted by AWB Limited, ABB Grain, GrainCorp, and AusBulk may have mitigated the potential for vaguely-defined property rights problems to some extent, in particular the free rider, portfolio, horizon, and control problems. However, these hybrid grower-investor ownership arrangements have created the potential for new conflicts that exacerbate the influence costs problem, and may also create control problems if growers feel that management is not achieving an appropriate balance between meeting the needs of growers as users of the business and those of investors.

The most significant feature of the investor share-cooperative structures that may be beneficial in terms of reducing property rights problems is the establishment of tradable and appreciable equity shares. As described in chapter five, the establishment of tradable and appreciable shares with well-defined rights reduces the potential for free

[141] Some industry analysts have gone so far as to suggest that the merged CBH-Grain Pool may be able to overcome traditional grower opposition to cooperative structural change, and will consequently list on the ASX in the near future (Byrnes, 2002).

rider, horizon and portfolio problems. As such, these organizations have a greater degree of financial flexibility because their ability to attract risk capital is enhanced, and growers can access their equity at market-determined values. Moreover, the attachment of minority voting rights to these shares may increase their attractiveness to non-user investors, thereby improving the market liquidity of these shares.

In terms of the free rider problem, the establishment of tradable equity shares whose rights are allocated according to investment level rather than use implies that a grower's decision to patronize the business has no direct effect on investors' shareholdings, as equity is not diluted when growers patronize the business. In this manner, the internal free rider problem is reduced, as growers who have shareholdings in the organization do not have to worry about potential equity dilution when other growers patronize the business[142].

Although the creation of tradable equity shares may alleviate internal free rider concerns, its impact on the external free rider problem is negligible. As explained in chapter five, an external free rider problem occurs when individuals can benefit from the organization's activities without sharing in the associated costs. An example is a grower who does not use the organization's marketing services, but benefits from higher market prices generated by the organization's effect on the overall terms of trade in the industry. Whereas the external free rider problem was not a concern to the former statutory organizations because legislation restricted competition and therefore growers had no

[142] Although all shareholders, regardless of grower or non-grower status, may be concerned about possible dilution of equity value if the organization issues new equity, this concern is common to all organizations that utilize share capital arrangements, not just to organizations with investor-share cooperative structures.

choice but to utilize their products and services, in a deregulated environment the external free rider problem is more likely to arise, as growers have a choice as to whether they actually patronage the business, but may still benefit from the organization's activities in the marketplace[143]. For example, if by virtue of its market size and export single desk activities[144], AWB Limited is able to generate higher prices for Australian wheat in the domestic market, growers can benefit from those efforts without actually having to market their domestic wheat through AWB Limited. In such a scenario, growers can benefit from AWB Limited's marketing efforts without contributing to its operations.

In terms of the portfolio problem, since equity in the investor share-cooperative entities is tradable and appreciable, and since the decision to patronize the business is no longer tied to the decision to invest in the business, growers are able to adjust their individual equity holdings to match their personal risk-return preferences. As such, the portfolio problem is reduced. Because growers have the opportunity to sell their shares if they are uncomfortable with the organization's investment strategies, they no longer have to rely solely on the tactic of pressuring the organization's directors and management to undertake certain types of activities that reflect their individual attitudes towards risk. The potential for portfolio problems may not have been as great during the regulatory period in which these entities were restricted by legislation to a specific geographic territory or narrow business function: Given the protections afforded by legislation (for example, exclusive marketing rights and government-guaranteed financing), the risk

[143] Of course, the free rider problem is lessened for those organizations that retain single desk rights, most significantly AWBI and its exclusive right to export bulk Australian wheat: Growers have no other choice but to market export bulk wheat through AWBI.

[144] In this respect, AWB Limited's estimate of National Pool export returns, updated and published bi-weekly, is one of the biggest influences on domestic wheat prices in Australia.

profile of these organizations was relatively low. However, since the removal of their statutory privileges these entities have increasingly ventured into new regions and business activities, and their risk profiles have consequently changed. In this altered environment, growers must determine whether their personal tolerances for risk are compatible with the organization, and adjust their investment holdings accordingly. Tradable equity shares enable them to do so, and provide opportunities for non-grower investors, including institutional investors[145], to acquire the organization's stock if its risk-return profile suits their investment goals.

Potential reduction of the portfolio problem is greatest for AWB Limited, ABB Grain, and GrainCorp, as their stock is traded on the relatively liquid ASX, where price discovery of the stock's underlying value should be reasonably sophisticated[146]. In comparison, AusBulk's stock is currently trading on a less liquid introductory market, in which growers may be more reluctant to trade their shares if they do not believe the stock price fully reflects its underlying value. AusBulk itself has acknowledged that such an introductory market is cumbersome and results in shares trading at a discount, and is one of the primary reasons why the company intended to list on the more liquid ASX.

Because equity rights are no longer linked to growers' use of the business, the horizon problem in the investor-share cooperative structures is also alleviated. With

[145] Institutional investors include pension funds, insurance companies, and mutual fund managers (Trechter et al, 2003).

[146] As Jensen and Meckling (1979) point out, the marketability of an organization's shares facilitates the specialization of risk bearing among individuals with differing degrees of risk aversion and wealth, which may lead to a more efficient distribution of risk. This is particularly true for entities such as AWB Limited, whose size in terms of market capitalization and inclusion in the ASX/S&P100 index may increase the stock's attractiveness to investors such as institutional fund managers.

tradable equity shares, growers no longer have to match the duration of their equity holding with the duration of their patronage of the business in order to receive the benefits associated with the former. Furthermore, because tradable shares represent rights to receive net cash flow (in the form of dividends) over the life of the organization, the net present value of the organization's long-term investment potential should be reflected in the share's market value. If this occurs, then growers have a reduced incentive to pressure the organization's board and management to maximize short-term payoffs at the expense of sacrificing projects that have greater but longer-term potential. With the existence of tradable and appreciable equity, growers receive organizational benefits from both their equity holding[147] and their use of the business's products and services.

As described above, listing on the ASX may have reduced the horizon, portfolio, and internal free rider problems for AWB Limited, ABB Grain, and GrainCorp. Listing a class of shares on a well-functioning public stock exchange such as the ASX facilitates access to capital and increases liquidity for investors[148]. Listing may have also reduced the control problem for these organizations. As explained in chapter five, the reporting requirements and public monitoring of corporate activities that typically accompany publicly-traded stock reduces the control problem, as it places greater disciplines on the behaviour of the organization's management[149]. In terms of public monitoring, AWB

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[147] Growers have two possible streams of benefits from tradable and appreciable equity rights: dividends received from their shareholdings, and capital gains attained if their shares have appreciated in value when sold.

[148] In their examination of AWB Limited, Trechter et al (2003) similarly conclude that the organization's public listing of equity stock served as a means to address many of the structural challenges facing traditional cooperatives.

[149] Although listing on the ASX has increased monitoring, these organizations are currently not exposed to the threat of takeover that otherwise serves as another form of managerial discipline in IOFs. AWB Limited and ABB Grain have specified maximum limits on individual shareholdings of 10 and 15 percent,

Limited, ABB Grain, and GrainCorp must all comply with the reporting requirements of the ASX, and their stock performances are closely followed by financial institutions and professional analysts, ratings agencies, and Australia's financial press. As a result, the realm of publicly-available information about these organizations is vastly increased, which gives investors, whether growers or non-growers, an increased ability to assess the organization's performance. Even AusBulk has acknowledged that its intention to list on the ASX in 2004 had an effect on its information reporting, noting that its 2003 annual report included more extensive disclosure of information than in previous reports, in order to reflect ASX reporting requirements for listed entities (AusBulk, 2003d).

Although growers retain formal control of these investor-share cooperatives through majority voting rights, minority voting rights have been attached to the organizations' equity shares. This is done to increase the attractiveness of the organization's stock to non-grower investors who provide risk capital but forgo formal organizational control to growers. In a report examining capitalization strategies of agricultural cooperatives in Canada, the EU, U.S., and Australia, Ernst & Young (2002) identified that allocation of some degree of voting influence to non-grower investors is a key component of a successful cooperative capitalization strategy:

> ...a co-op must decide how far it is willing to diverge from the traditional co-op model, particularly in terms of voting rights of members and non-members; the appreciation of member/non-member shares; the methods of surplus distribution (based on patronage or capital); the extent of non-member business; and the transferability of shares for both members and non-members. Our research found that a common hurdle to co-op capitalization was the desire to limit voting rights, and hence control, of outside investors. As such, non-member capitalization schemes that do not allow for reasonable outside investor control, have had limited success in all regions (50).

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respectively, and GrainCorp and AusBulk have mitigated the threat of takeover by establishing grower-restricted holding companies that maintain control of the operating entities.

Although the establishment of tradable and appreciable equity rights has helped reduce the potential for free rider, horizon, and portfolio problems, and the public listing of these shares has helped mitigate control problems, the hybrid grower-investor ownership structures of AWB Limited, ABB Grain, AusBulk and GrainCorp have created other difficulties not previously encountered. In particular, these structures have the potential for conflicts of interest between growers and non-grower investors, which may create influence costs problems as heterogeneous stakeholders attempt to influence the distribution of organizational benefits. These ownership structures may also create control problems if growers are not completely indifferent between receiving benefits as investors and benefits as users of the business. If growers favour receiving benefits through their use of the business (for example, in the form of lower storage and handling charges), then they may be dissatisfied with organizational decisions that are geared towards profit-seeking activities that aim to achieve investor objectives[150].

In investor-share cooperative structures such as AWB Limited, ABB Grain, GrainCorp and AusBulk, the organization must meet the objectives of both growers and shareholders, the latter of whom may include non-grower investors. However, the objectives of these two groups may conflict with one another. This potential for conflict arises because, in their role as users of the business, growers may have organizational objectives that clash with those of investors who have no other involvement with the organization other than as providers of risk capital. Whereas non-grower investors are

[150] A tendency for Australian growers to favour user-derived benefits relative to returns from organizational equity may be relevant. Based on consultations with growers conducted for a GCA-led industry strategic planning process, Storey Marketing (2003) commented: "While a high percentage of growers have capital (through shareholdings) invested in supply chain operators, they are very clear that their farm bottom line is more impacted by the efficiency and cost of the supply chain for their grain outputs, than by any dividend stream from the shares" (5).

solely concerned with its ability to generate a return on the capital they have invested, growers want the organization to meet their needs as both investors (if they have equity invested) and users. The interests of growers in this latter role may directly conflict with the interests of non-grower investors[151].

If conflicts between growers and non-growers exist, then both groups have an incentive to pressure the organization's directors and management to undertake activities that benefit their interests at the expense of the other. These pressures can lead to influence costs for the organization, as the board and management must undertake efforts to resolve these conflicts. These conflicts can also lead to control problems if growers, who maintain formal control of the organization through a majority presence on the board, feel that management is making operational decisions that unduly favour investor objectives over those of growers in their role as users of the business.

Combining growers with non-grower investors in an organization's ownership structure leads to a general question: Whose interests take priority for the organization: serving the needs of growers as users or serving the needs of shareholders? Similarly, can an appropriate balance between these two interests be maintained? Although this may not be as great a concern when growers comprise the majority of the firm's shareholders (and

[151] For example, when a grower utilizes the financial lending services of the organization, he wants the organization to minimize the interest and other financing costs associated with the loan. In contrast, non-grower investors want the organization to maximize the margins associated with offering that financial product, as this increases the earnings ultimately available for distribution to shareholders. In this situation, the interests of growers and non-growers are directly in conflict, as efforts to increase the organization's profit margin result in increased costs to the grower for his individual farming operation. Grower objectives as users of the business conflict with the profit maximization objective of investors.

there is therefore overlap between the two groups), the possibility for conflict becomes greater if the balance between grower- and non-grower shareholdings begins to shift.

7.3.3 Industry tensions and perceived conflicts of interest

Perceived conflicts of this type have surfaced in the Australian grains industry, and have led to industry tensions among growers and the various organizations examined in this thesis. These problems have been exacerbated by the government-granted single desk rights held by some organizations.

Grower concerns about the various grower-investor ownership structures currently in place in Australia were identified during an industry-wide strategic planning process[152] in 2003. Consultations with growers during this process noted concerns about the dual responsibilities of ASX-listed companies to manage single desks on behalf of growers and engage in commercial activities on behalf of shareholders. Grower concerns about possible conflicts of interest in these arrangements were summarized as follows:

> Growers have a long history of trust in their single desk operators (AWB, ABB, Grain Pool of WA). The changes over the past three to five years, where SDS [single desk selling] operators have moved from having a single bucket of money (grower returns) to two buckets of money (grower and shareholder returns), have left growers uneasy about the outcome and the inherent conflicts of interest. The incumbent SDS operators advise them that governance procedures are in place, whereas others advise that "you can't serve two masters"; and that the lack of transparency and contestability for services undermines grower confidence in the SDS system. Growers would prefer to see clear, unambiguous responsibilities for SDS operators to grower interests alone, and not confuse that purpose with competition for other services which growers purchase in the market (Storey Marketing, 2003: 7).

Given its size and importance to the industry as the single desk wheat exporter, the greatest concerns are directed towards AWB Limited. In particular, controversy surrounds its exclusive role in providing export pool management services to AWBI, its

[152] This strategic planning process was organized and led by the GCA.

increasing involvement in non-regulated business segments as a direct competitor with other industry players, and its dual class share structure. Some growers have questioned whether it is possible for AWB Limited to both maximize net export pool returns to growers and meet the commercial objectives of shareholders, while industry players such as CBH, AusBulk and GrainCorp have become increasingly critical about its single desk privileges and the competitive advantage this may provide in other business segments, as well as the overall impact this has on net benefits to growers[153].

Although the organization has attempted to separate its profit-seeking activities from the activities involved in maximizing grower returns from the single desk (through the parent AWB Limited and subsidiary AWBI, respectively), critics contend that the transparency and separation between these two income streams is insufficient. Included among these concerns is the design of the performance-based remuneration model that determines AWBI's compensation to AWB Limited for its pool management services, which ultimately affects growers' returns from the single desk[154]. Furthermore, although part of the WEA's regulatory functions is to monitor the performance of AWBI and report on whether it is maximizing single desk benefits to growers, critics assert that the WEA does not have sufficient powers to effectively perform this regulatory oversight role, nor can it effectively monitor AWBI's relationship with AWB Limited.

[153] As Bolt (2002d) explains, "there is scarcely an organization in the industry not pointing to a lack of transparency and conflicts of interests between [AWB Limited's] need to make profits for shareholders and the leverage it gains from continuing to manage the wheat-export monopoly".

[154] For example, in 2004 GrainCorp's grower-owned holding company, GGA, criticized the performance-based remuneration arrangement, asserting that it allows for excessive compensation that benefits AWB Limited's shareholders but reduces export pool returns to growers (Bolt, 2004).

As mentioned in chapter four, concerns about the dual class share structure of AWB Limited and its potential conflicts were evident during a 2003 senate inquiry. The senate committee heard from various individual growers and grower organizations[155] who contended that AWB Limited could not simultaneously maximize grower returns from the export single desk and satisfy its B-Class shareholders. Growers expressed concern that AWB Limited's commercial profit-seeking activities are benefiting the company at the expense of growers' net export pool returns generated by AWBI. Although growers currently comprise the majority of AWB Limited's B-Class shareholders, and therefore benefit from the company's profit-seeking activities, they argue that it is reasonable to expect non-grower ownership of AWB Limited to increase as growers sell their shares in an effort to diversify their financial shareholdings and lessen their exposure to agriculture-related activities (Wheat Growers Association, 2003). If this occurs, then concerns about the profit-seeking activities of AWB Limited versus the single desk activities of AWBI will be even greater. The basic quandary arising from AWB Limited's dual role as single desk manager and profit-driven company has been summarized as follows:

> As is now recognized within the structure of AWBI and AWB Limited there is a tension between the interests of growers and the interest of shareholders. This is because payments must be made to shareholders who increasingly may not be wheat growers. These payments will use some premiums obtained through the single desk and any profits made in the overall wheat trade supply chain which in earlier times [i.e. prior to AWB's privatization] were passed along to growers. This may be the price to be paid for access to capital markets and will require long-term management to ensure growers returns are maximized subject to a payment of returns to shareholders (MacAulay, 2003: 3).

[155] Submissions from growers and grower organizations included Carberry (2003); Warrine Pastoral Company (2003); Wheat Growers Association (2003); Harvey (2003); and Victorian Farmers Federation (2003).

In addition to grower concerns about AWB Limited, the traditional bulk handlers[156] have also been highly critical. As mentioned in chapter four, these organizations have criticized AWB Limited's role in managing the single desk and have sought greater contestability of services for export wheat along the supply chain. Among their complaints are the appropriateness of granting a publicly-traded company exclusive rights to manage the single desk, and whether conflicts necessarily arise between the need to maximize grower returns from the single desk and the need to satisfy AWB Limited's shareholder objectives[157].

Conflict of interest concerns have also been directed towards the traditional bulk handlers and their current organizational structures. AWB Limited has been particularly critical of these organizations, asserting that their criticisms of AWB Limited are purely driven by efforts to maximize returns to their own shareholders at the expense of net export pool returns to Australian wheat growers. AWB Limited's managing director and chief executive officer has summarized this perspective as follows:

> As those companies begin to privatize, they have a clear fiduciary duty to serve only their shareholders, and that is exactly what they are doing. If part of that servicing to shareholders includes taking a larger slice of the single desk benefit that currently accrues to the national pool participants, then clearly that is what they are about. I would submit that many of the debates and issues that are around in the industry are really driven by commercial self-interest, not just that of the usual suspects, like the Cargills and the international grain traders—although they are now increasingly involved in the Australian grains industry—but also that of a number of the traditionally farmer owned and controlled companies that now only have one duty: to maximize the returns to their shareholders (Lindberg, 2003: 129).

The tensions that currently exist among Australia's industry stakeholders regarding issues such as conflicts of interest between growers and investors creates

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[156] Including the grower-owned holding companies of AusBulk and GrainCorp—UGH and GGA, respectively.
[157] Some examples of the public criticisms these organizations have directed towards AWB Limited are presented in Appendix 1.

influence costs, as organizational resources must be dedicated to addressing these conflicts and improving relations with stakeholders, most notably growers. Time and resources are required to listen to growers, understand their concerns, and address the issues. For example, in response to criticisms about the performance-based pool management remuneration arrangement between AWB Limited and AWBI, the company's chief executive officer wrote a public letter to growers assuring them that the new remuneration model was in their best interests (Lindberg, 2001). More generally, AWB Limited has stated its intention to work jointly with the GCA to consult with growers in order to gain a greater understanding of the perceptions they have of its organizational structure, and how any related concerns can be overcome[158] (AWB Limited, 2003d).

The time and effort required by directors and senior management to address these types of concerns can be substantial, as was demonstrated with the significant participation of key industry officials during the 2003 senate inquiry. As mentioned in chapter four, given the formal review of AWBI in 2004, it is expected that significant influence activities by growers and Australia's major organizations will continue in the near term. Indeed, public criticisms related to the above-mentioned issues have already arisen between AWB Limited and GrainCorp's holding company GGA during the preliminary stages of the 2004 review process (Day, 2004).

[158] In stating the reasons why AWB Limited sought to consult with growers, the company's chairman noted that "a general lack of understanding of the AWB Group's structure has unfortunately provided vested interests with an opportunity to spread misinformation about the operation and objectives of AWB and its management of the single desk" (AWB Limited, 2003d). Such a remark was presumably an indirect reference to organizations such as the traditional bulk handlers and their public criticisms of AWB Limited.

The concern among Australian growers and other industry stakeholders that hybrid grower-investor ownership structures have the potential to place shareholders' interests above those of growers is consistent with the cautions Chaddad and Cook (2002, 2003), Fulton and Gibbings (2000), and Torgerson et al (1997) have noted about these types of structures: The organization may begin to behave more and more like an IOF rather than a cooperative geared towards serving growers' interests. Moreover, these tensions are consistent with Trechter et al's (2003) caution that the hybrid ownership structure of AWB Limited may not be sustainable if non-growers increasingly acquire the company's stock: If this occurs, the authors warn that grower control of AWB Limited will become impracticable, as non-grower investors will demand greater influence over the organization. If control is not gained, investors may want to sell their stock, a move which would drive down the share price and consequently erode AWB Limited's financial strength.

Similar to the views held by Trechter et al (2003), one Australian market analyst has commented that eventual loss of grower control of these hybrid organizations is an inevitable tradeoff when seeking non-grower capital:

> Definitely some members were worried that they would lose control. But I think that as they move from being entities designed to assist farmers to companies designed to create shareholder value, there will be an acceptance that loss of control is not a bad thing, because outside capital moves in...The idea of moving on to the stock exchange has to be to lose control over time (Dunn, 2003).

Further time is needed to determine whether the hybrid investor-share cooperative structures of Australia's major agribusinesses will remain, or whether a further transition towards IOF arrangements will occur, in which the cooperative principle of grower control no longer exists.

7.4 Summary

The evolution of the Australian grains industry, in particular five major grain marketing and handling organizations, have been examined from the perspective of cooperative life cycle theory. All five entities began through statutory arrangements that represented responses to grower concerns about market failure problems associated with the open market. Through exclusive government-granted rights, these entities operated as compulsory cooperatives in which growers maintained control over the marketing, storage and handling of Australia's major grains. As time progressed, concerns about the overall efficiency of these arrangements became increasingly prominent, and changes were made that substantially altered the competitive environment in which these entities operated. Faced with an increasingly deregulatory environment, these organizations embraced strategies of growth and diversification, and contemplated whether their traditional structures of control and equity were capable of supporting such strategies and meeting growers' needs. In response, the majority of these entities adopted organizational structures that maintained the cooperative principle of grower control but established tradable and appreciable stock that allowed for ownership participation by non-grower investors. Although the adoption of such hybrid structures may have alleviated some of the problems associated with vaguely-defined property rights, in particular those related to capital accumulation and grower access to equity, other difficulties have arisen, primarily in relation to perceived conflicts of interest between growers as users of the business and investors. Exclusive single desk privileges granted to some entities have exacerbated these difficulties, as they have created tensions among industry participants.

Chapter 8 Conclusions

8.1 Conclusions

This thesis has examined organizational changes in the Australian grains industry, in particular the evolution of five major marketing and handling organizations. These entities were originally conferred with exclusive rights that enabled them to behave in a manner similar to compulsory cooperatives. However, since deregulation began in 1989, these entities have undergone various transformations in terms of both organizational structure and business strategies. In order to gain a greater understanding of why these changes have occurred, this thesis has examined the Australian experience from the perspective of cooperative life cycle theory. Although the theory has provided a useful framework in which to understand organizational change in Australia, there are some areas where the theory can be improved in this regard.

Similar to what cooperative life cycle theory suggests, the five Australian organizations examined in this thesis emerged as collective grower responses to market failure problems associated with the open market. Backed by exclusive rights and powers granted by Australia's federal and state governments, these entities were organized to retain grower control of the marketing and handling of their commodities and increase their collective market power. Compulsory pooling of revenues and costs was designed to achieve grower equality and the sharing of risks among growers, with government support. These organizational arrangements remained relatively unchanged for many years, largely because growers perceived benefits associated with the statutory arrangements, and because the regulated grain marketing and handling system was consistent with Australia's regulatory approach in other economic sectors. However, consistent with what stage three of cooperative life cycle theory suggests, an increasing concern about industry costs and efficiency eventually emerged, and Australia's statutory marketing and handling arrangements became subject to greater scrutiny. A major turning point for the industry subsequently occurred in 1989, when deregulatory changes fundamentally altered the industry environment. In particular, deregulation of the domestic wheat market and the removal of bulk handlers' sole receival rights introduced competitive market forces. Moreover, the establishment of a mandatory grower-funded capital base for the flagship AWB signaled that growers would eventually be responsible for the organizational risks that the federal government had previously assumed on their behalf. Adoption of further competition policy reforms in the 1990s continued Australia's general deregulatory push, and the organizations found themselves in a markedly different operating environment, one in which they were no longer restricted by regulation to a particular geographic region or business function.

Within this increasingly competitive environment, the Australian organizations decided that strategies of growth and diversification along an increasingly integrated value chain were required if they were to remain viable. In turn, the organizations looked inward to determine whether they were appropriately structured to pursue such strategies. In this regard, concerns about maintaining grower control of the organization emerged, as well as concerns about the organization's financial flexibility and growers' access to the organizational capital they helped build over the years. In many respects, these concerns reflect the five vaguely-defined property rights problems identified in the cooperative life cycle: The control and influence costs problems relate to issues of organizational control and the relationship between owners and management, whereas the free rider, horizon, and portfolio problems pertain to issues of capital accumulation, valuation, and grower access to cooperative equity.

Consistent with the later stages of cooperative life cycle theory, the Australian entities underwent organizational planning processes in which such issues were considered. The outcomes for four of the five entities examined—AWB Limited, ABB Grain, AusBulk, and GrainCorp—were restructurings into hybrid grower-investor ownership arrangements. In such arrangements, grower control is separated from equity ownership, which is no longer restricted to growers. Moreover, equity is tradable among investors on a liquid secondary market, where it can appreciate or depreciate in value. In terms of the cooperative life cycle, such hybrid structures represent Cook's (1995) alternative of continuing in some modified cooperative form, as well as Chaddad and Cook's (2002, 2003) investor-share cooperative category. These organizational forms retain the traditional cooperative principle of grower control, but introduce features of tradable ownership rights more characteristic of IOFs. For the entities that have also retained single desk marketing privileges—AWB Limited, ABB Grain, and CBH—they have established wholly-owned subsidiaries that also maintain the traditional cooperative practice of orderly marketing and pooling on behalf of growers.

In contrast to the hybrid ownership structures adopted by AWB Limited, ABB Grain, GrainCorp, and AusBulk, one organization—CBH—has chosen to maintain a traditional cooperative structure, in which both ownership and control is restricted to growers, and equity is non-tradable and non-appreciable. The traditional cooperative structure was maintained after CBH's growers rejected a proposal by the organization's board and management to restructure the entity into a dual class share model. Similar to what Royer (1992) and Chaddad and Cook (2002) suggest, CBH's experience reflects the importance of understanding growers' fundamental orientation towards change, as growers ultimately determine the extent to which organizational restructuring can occur.

In summary, the five Australian organizations examined in this thesis appear to have followed a pattern similar to that described by cooperative life cycle theory: Formed as a defensive reaction to protect growers' interests, the cooperative eventually encounters difficulties as it matures and its environment changes. In the Australian context, deregulation substantially altered the industry environment by exposing the organizations to competition and removing restrictions placed on their operations. In an effort to position themselves in a more open environment and prepare for the anticipated deregulation of the wheat export market—a move that is expected to lead to increased global competition—these entities have become more offensive in nature, pursuing strategies of growth and diversification. Moreover, they have altered their organizational structures to accommodate these pursuits and generate sufficient financial flexibility, both in terms of accessing new sources of equity and allowing growers access to the organizational equity they helped accumulate during past years. At the same time, however, growers have maintained formal control of these organizations, a feature characteristic of more traditional cooperative efforts by growers to advance their economic interests past the farm gate. In this respect, these Australian organizations represent Sykuta and Cook's (2001) definition of producer-oriented firms.

8.2 Suggested improvements to the theory

Although cooperative life cycle theory has provided a useful framework in which to examine organizational change in the Australian grains industry, the analysis conducted in this thesis suggests there are areas where the theory can be improved. First, forces external to the organization that influence change should be given greater attention in the life cycle. In the Australian experience, the role of regulation and changes in approach to government policymaking had a significant effect on the organizations examined. Regulation effectively eliminated competition in the Australian industry altogether, and in some cases, particularly for the export of bulk Australian wheat, remains so in 2004. Cooperative life cycle theory must be flexible enough to incorporate particular regulatory features of an industry (such as single desk marketing arrangements) into its framework, in order to better explain how such regulatory arrangements, and changes in these arrangements, affect the organizations involved. More generally, external stimuli which alter the overall industry environment should be given adequate attention in cooperative life cycle theory, as these factors, combined with internal vaguely-defined property rights problems, affect decisions regarding organizational change.

Another issue that needs to be further addressed in cooperative life cycle theory is the innovative organizational forms that cooperatives adopt in later stages. In particular, the theory should further examine hybrid grower-investor ownership structures such as those identified by Chaddad and Cook (2002, 2003) to determine whether they represent sustainable solutions for vaguely-defined property rights problems, or whether conflicts of interest between growers and non-grower investors will eventually arise and create new difficulties for the organization. As this thesis has demonstrated, conflict of interest issues have arisen in the Australian grains industry: Although the investor-share cooperative structures of AWB Limited, ABB Grain, AusBulk and GrainCorp may have reduced the potential for free rider, portfolio, horizon, and in some respects control problems, conflicts of interest between growers and non-grower investors in these structures may lead to increased influence costs, as well as control problems if non-grower investors seek eventual control of the organization. The inclusion of both growers and non-grower investors in these ownership structures raises the question of whose interests the organization ultimately serves: the grower as the primary user of the business, or the investor seeking a return on capital invested, and whether an appropriate balance between these two interests can be achieved. Cooperative life cycle theory should further examine these sorts of hybrid ownership structures to determine whether they represent long-term solutions to weaknesses associated with traditional cooperative property rights, or whether they instead represent a transitional step towards IOF arrangements, including the eventual loss of grower control.

8.3 Recommendations for further study

Many observers of the Australian grains industry contend that the period of organizational change is not over. Further rationalization of the industry is expected[159] as organizations continue to seek out greater efficiencies, and the single desk export privileges that currently exist will be the subject of further debate in the next several years. Domestic events such as the scheduled 2004 review of AWBI's management of

[159] For example, some industry observers expect that, if the remaining single desk export wheat and barley markets are deregulated, further industry rationalization will result in only two remaining Australian companies competing with multinational grain players (Bolt, 2001c).

the wheat export single desk will serve as forums for stakeholders to express their concerns about the current state of the industry, the tensions that exist as a result of these arrangements, and the ownership structures of the organizations involved. Furthermore, international events such as the outcome of the current round of WTO negotiations may have implications for Australia's remaining regulatory arrangements, including the compulsory cooperative features that characterize single desk export marketing.

As further changes in the Australian grains industry are anticipated, an important element to consider is whether the organizational structures that currently exist in the industry will remain over the longer term, and what role growers will play in future arrangements. In this respect, further time is needed to determine whether the investor-share cooperative structures of AWB Limited, ABB Grain, GrainCorp and AusBulk, as well as the traditional cooperative structure of CBH, represent long-term arrangements for these entities. More generally, a longer duration of study is needed to determine whether grower control of Australia's major grain marketing and handling organizations will continue as a cooperative feature of the industry, or whether non-grower investors will increasingly play a greater role. A related issue is whether ownership structures that entail dual objectives of meeting the needs of growers and investors are sustainable in the long run. Although conflicts of interest between growers and investors may not be a significant problem when growers hold the majority of equity investment in these organizations (as is currently the case in Australia), conflicts may become more pronounced if growers increasingly sell their equity to non-grower investors. If this occurs, then large non-grower investors may increasingly pressure the organization towards activities that increase shareholder value at the expense of growers as users of the business.

Given the continuing state of flux in the Australian grains industry, further study of its marketing and handling arrangements over the next five to ten years is recommended, in order to determine whether the grower-controlled ownership structures that currently exist will remain in the future. Such study will be invaluable to determine whether these organizational structures are in fact a viable alternative in the later stages of the cooperative life cycle, or whether they are instead a transitionary step towards more investor-oriented arrangements. More generally, a further examination of the Australian experience will contribute to a greater understanding of cooperative evolution, and what role growers can play in an increasingly competitive and globalized agricultural marketplace[160].

In addition to further study of the Australian grains industry, another area of recommended research is to compare the organizational changes that have occurred in Australia with those of other countries. One example would be the organizational changes that have occurred among cooperatives in western Canada's grains sector: Since the 1990s, several marketing and handling organizations have undergone structural changes that have altered their traditional cooperative nature to varying degrees. Traditionally known as SWP, Alberta Pool, Manitoba Pool Elevators, and United Grain

[160] Further study of this issue would complement work being done elsewhere. In the U.S., for example, policymakers are examining what changes can be made to help increase farmers' influence past the farm gate. The U.S. Congress has recently undertaken initiatives to explore possible legislative changes to help farmer cooperatives evolve, including the extent to which laws should be modified to allow for greater flexibility in cooperative business and governance structures (Campbell, 2003).

Growers, these organizations played a significant role in the formative years of western Canada's grains industry. As a result of several mergers and restructurings, however, today's western Canadian industry is markedly different. Furthermore, the history and evolution of the Canadian Wheat Board, the single desk marketer of western Canadian wheat and barley for export and domestic human consumption, can be compared to that of Australia's statutory AWB.

Although this sort of country-to-country comparison can be useful in understanding how grower cooperatives in different countries have evolved, such a comparison must be properly done. Any attempt to compare the evolution of Australia's grain marketing and handling organizations with those of Canada must take into account the particular characteristics that distinguish each country and its grains industry. In this respect, factors such as geography, agronomics, regulatory policy, politics, and private sector competitors are all important in understanding each country's grains industry and its evolution over time. Such factors must be taken into account in order to have an accurate understanding of the issues facing growers and their organizations in each country. Only then can a relevant comparison be made to determine whether Australian and Canadian grain growers and their cooperative organizations have faced similar issues at the beginning of the 21st century.

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Appendix

Conflict of interest concerns raised by industry stakeholders about AWB Limited

United Grower Holdings (grower-owned holding company of AusBulk)

"There is a lack of contestability of services, accompanied by inadequate accountability and transparency between export monopoly holders and growers. This is causing considerable doubt that growers interests are being protected and that their on farm returns are being maximized" (4).

"...there are some cases where the managers of export monopolies appear to be making profits at levels greater than normal market rates from interacting with, and providing services, to the export pools" (4).

"Many growers remain supportive of the single desk concept, however, many are also concerned about the way its [sic] is being administered and are confused as organizations they consider to be acting in grower interests continue to openly dispute with each other. Most growers acknowledge that there are problems with the existing arrangements, but remain unsure how to fix it" (70).

Source: Kronos Corporate, 2002

Grain Growers Association (grower-owned holding company of GrainCorp)

"As the manager of grain logistics and freight contracts for the single desk, AWB Limited has the power to control the detailed arrangements for wheat movements in ways which benefit shareholders, potentially at the cost of growers...These are all conflicts of interest which stem from a potential confusion between shareholder and grower returns. The existence of this structural conflict means growers can never be sure their interests are protected" (7).

"The real problem is that the current model is flawed – we all know that nobody can serve two masters, and the current single desk arrangements where the grower company is a wholly-owned subsidiary of a publicly-listed commercial company means the conflict of interest is structural and fundamental" (7).

Source: GGA, 2002b

Co-operative Bulk Handling

"The non-contestable pool service agreement between AWBI and its sole supplier AWB Ltd, and the commercial objectives of the latter, are perceived by an increasing number of Australian wheat growers as a conflict of interest and lacking in transparency. This apparent lack of confidence is undermining support for AWB Ltd and orderly marketing, and is the single biggest threat to both AWBI and, ultimately, the sustainability of the wheat Single Desk" (13).

"The CBH proposal [to take over export pool management services in Western Australia free of charge from AWB Limited] eliminates potential conflicts of interest between the AWBI objective of maximizing pool returns and AWB Ltd's commercial interests and requirement to provide commercial returns to its investor shareholders" (13).

Source: CBH, 2002b