

Corporate Governance, Diversification, and Performance

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Agenda:

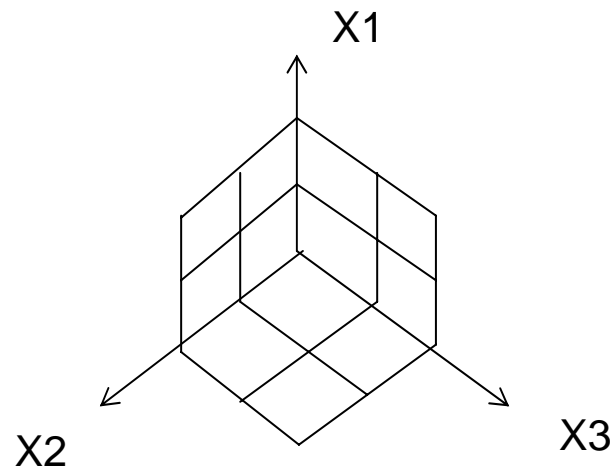
- 1 What is a cooperative?
- 2 Governance structure and diversification;
- 3 Board model and performance;
- 4 Single origin constraint;
- 5 Future research.

1 What is a cooperative?

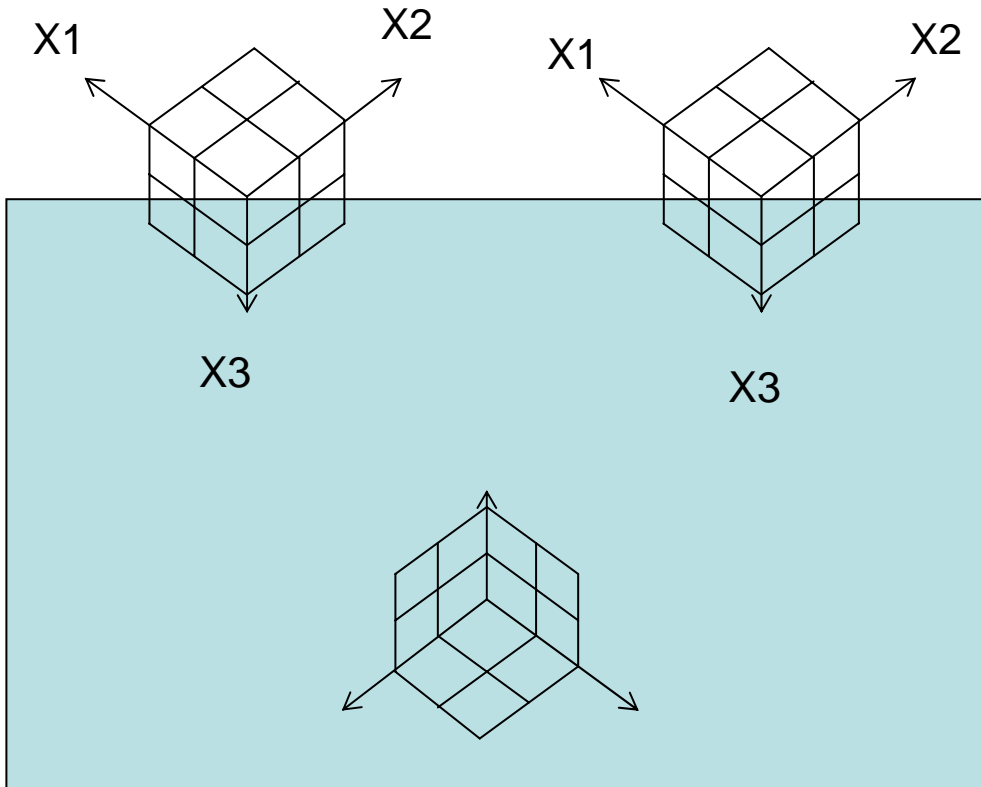
(joint with Li Feng)

Firm
owned by
many independent suppliers / buyers.

An enterprise as a system of attributes



IOF

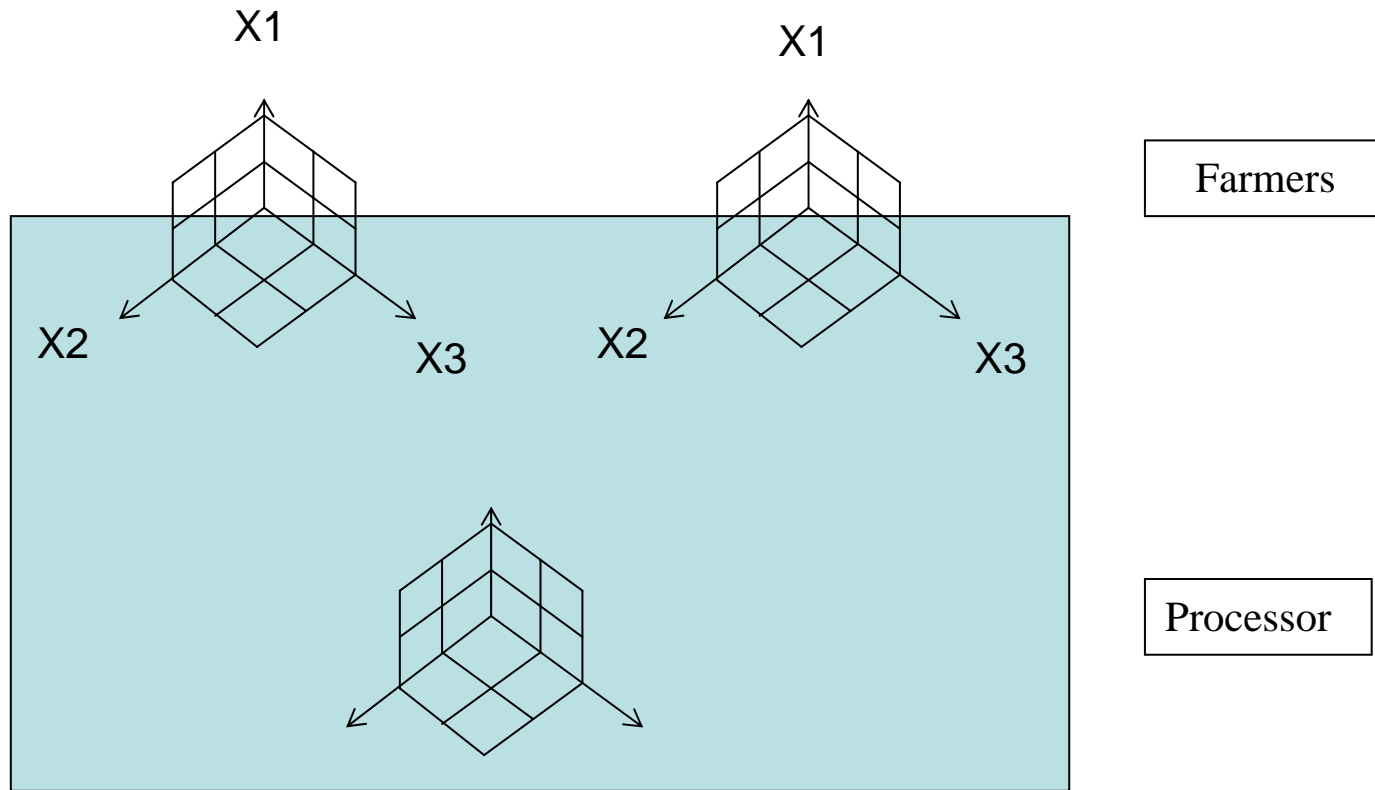


Investors

Processor

Ownership relationship

Cooperative



Ownership and transaction relationship



A cooperative is supposed
to serve member interests

and

to generate maximum value
in processing.



It is designed for the former task,

i.e. serving member interests,

and because the organizational structure
required for the two tasks is different,

it is expected to have an

impact on the latter task,

i.e. generating value in processing.

How do cooperatives behave?



Often the same as other firms.

Cooperatives appoint
a CEO and a team of managers
that are instructed to maximize profits.

**However,
in many cases,
the ownership structure
has an impact on
the firm's decision making,
especially with respect to input policy
(and therefore diversification activities).**

Research questions:

Does governance structure matter?
How does governance structure matter?

Is the difference driven by the cooperative structure or farmer orientation?
What aspect of governance structure or farmer orientation
is driving the difference?

2 Governance structure and diversification

(joint with Aswin van Oijen)

Does governance structure matter?

How does governance structure matter?

Is the difference driven by the cooperative structure or farmer orientation?
What aspect of governance structure or farmer orientation is driving the difference?

Sample:

164 companies in the Netherlands

82 cooperatives
82 public corporations

Empirical results,

while controlling for size:

- 1 Cooperatives are less diversified than corporations.
- 2 Cooperatives diversify less in related activities than corporations do.
- 3 The influence of unrelated diversification on financial performance is negative for cooperatives, while it is neutral for corporations.

Product portfolio of
IOF versus **Coop**

Unrelated diversification: two digit codes

	X		X
X	X	X	
X		X	X

	X	X	X
	X	X	

Related diversification: four digit codes

Conclusion

Governance structure matters.

3 Board model and performance

(joint with Jos Bijman and Aswin van Oijen)

Does governance structure matter?

How does governance structure matter?

Is the difference driven by the **cooperative structure**
(or farmer orientation)?

What aspect of governance structure (or farmer orientation) is driving the difference?

Background and rationale

- Changes in competitive environment of agricultural cooperatives
 - More market orientation / diversification
 - Internationalisation
 - Solving capital restraints
- ... may lead to restructuring of cooperatives
 - Of the transaction relation
 - Of the ownership relation

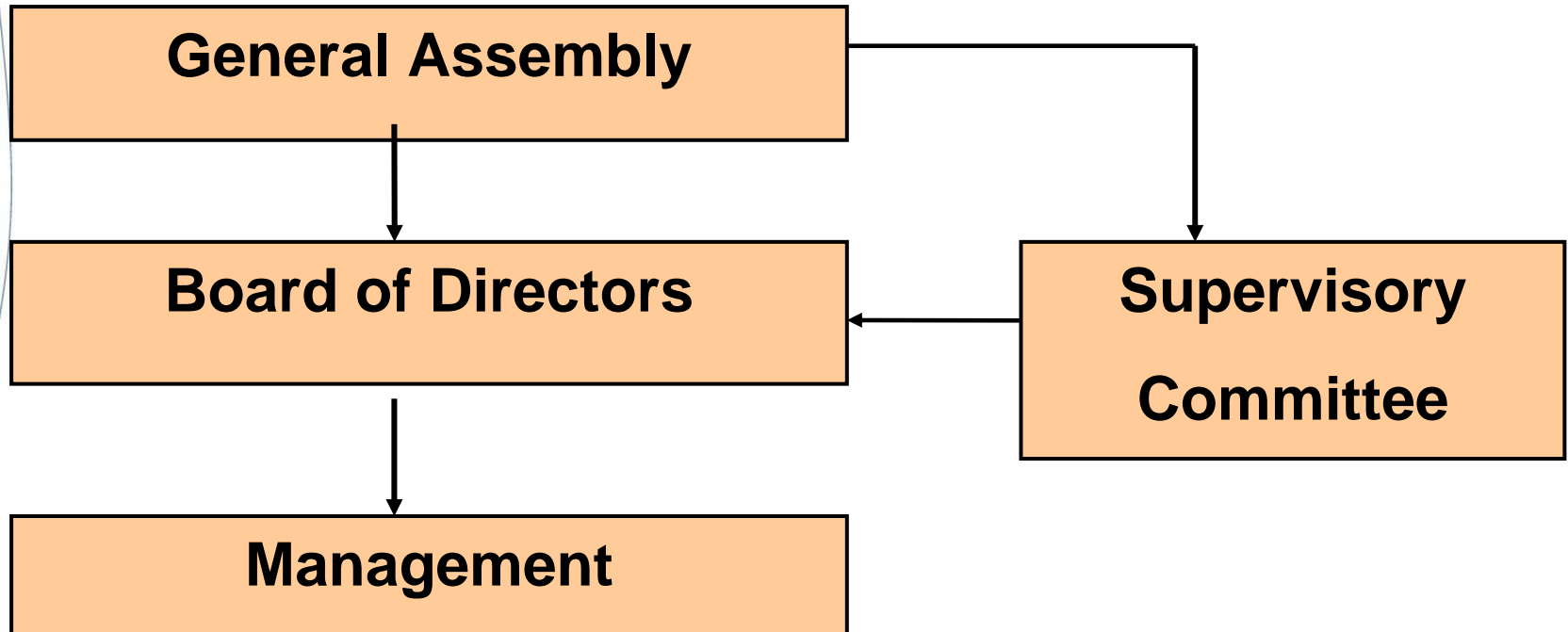
Governance changes in Coops:

- Shift of decision rights from BoD to management, and therefore changes in the role of the SC;
- Professionalization of BoD and Supervisory Committee (SC), and therefore changes in the composition of the BoD and SC;
- Incorporation of the cooperative firm, i.e. legal separation between society and firm.

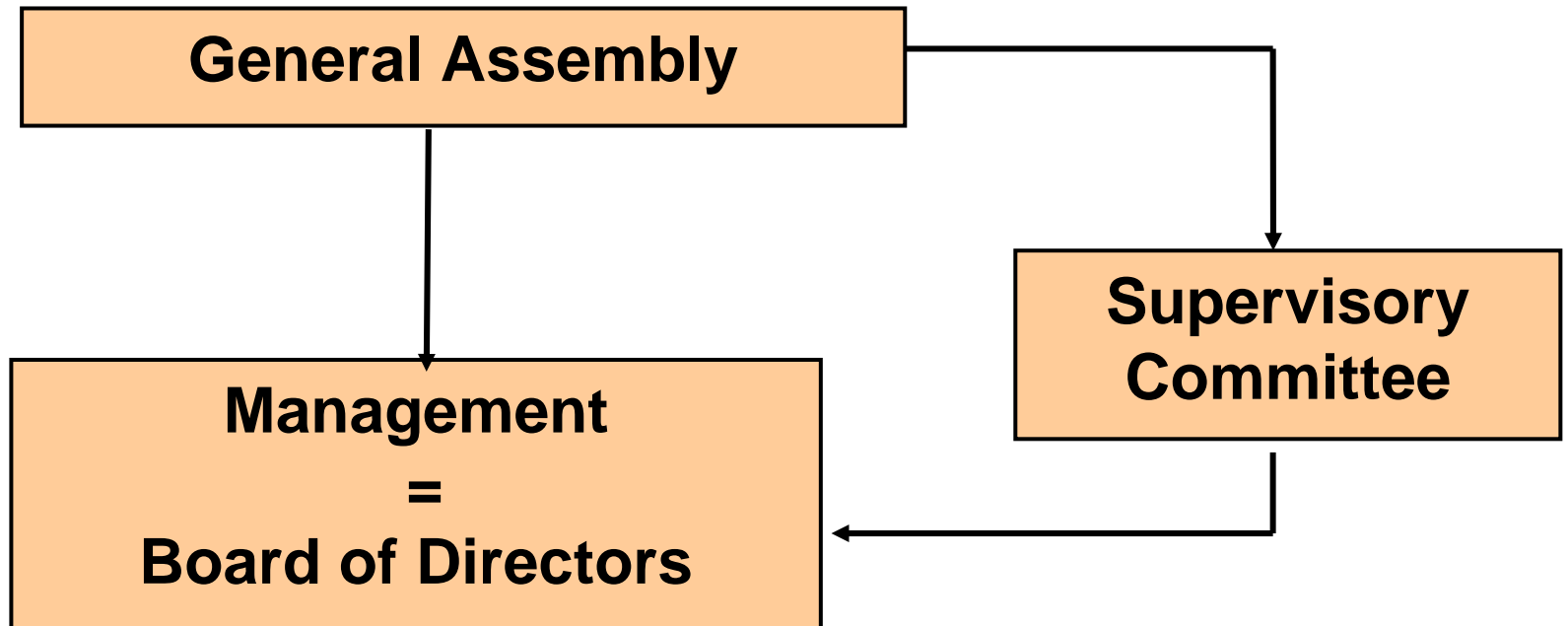
Three corporate governance models:

- Traditional model;
- Management model;
- Corporation model.

Traditional model:



Management model:



Corporation model:

General Assembly

**Board of Directors
=
Supervisory Committee**

Management

Corporation model:

General Assembly

Board of Directors

Supervisory Committee

Management

Sample:

- 24 cooperatives
- Dependent variables:
 - Return on equity
 - Return on total assets
- Independent variable
 - Company size
 - Dummies for board model
 - Product diversification
 - Interaction between board model and product diversification
- Multiple linear regression (OLS)

Empirical results regarding corporate governance and performance:

- Traditional board model has by far the best financial performance;
- Performance of coop (with traditional board model) is higher than performance of IOFs, but growth is lower.

Conclusion:

Board structure matters.

4 Single origin constraint

(joint with Ruud Smit)

Does governance structure matter?

How does governance structure matter?

Is the difference driven by the cooperative structure or **farmer orientation**?

What aspect of governance structure or **farmer orientation** is driving the difference?

Question:

What is the impact of governance structure on the evolution of the multi-product business firm?

Cooperatives and product portfolio:

- Portfolio problem;
- Horizon problem;
- Single origin constraint.

Single origin constraint:

Cooperatives will never divest products
requiring the inputs of members

Agent based simulation model

Characteristics of Product portfolio

- Each product is represented as a cell in a two-dimensional grid;
- A product has a lifetime and a number of units.

Product grid

(with 6 products and 17 units)

		5	2		
		1	3		
		4		2	

Main prescription of Diversification literature:

Concentric diversification strategy,
i.e. diversify only in activities related to
current products, markets, or processes.

Product portfolio evolution

A *transition rule* produces a new unit every period;

New units emerge within their local neighborhood of the current product portfolio.

Emergence probabilities are calculated based on the composition of the current product portfolio.

Divestment is captured by removing a product (with all its units) from the product portfolio when it has reached its lifetime.

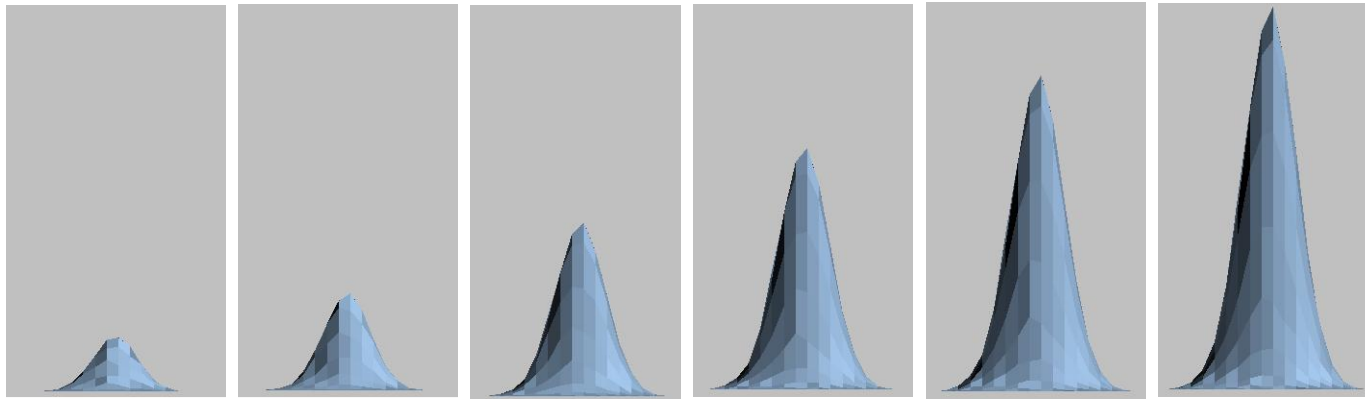
Three cases:

- All products have infinite lifetime;
- All products have the same finite lifetime (Corporation);
- One product has infinite lifetime and all other products have the same finite lifetime.

(The single origin constraint case / Cooperative)

Case 1: All products have infinite lifetime

Evolution of product portfolio shape - *infinite lifetime* -



Period:

500

1000

2000

3000

4000

5000

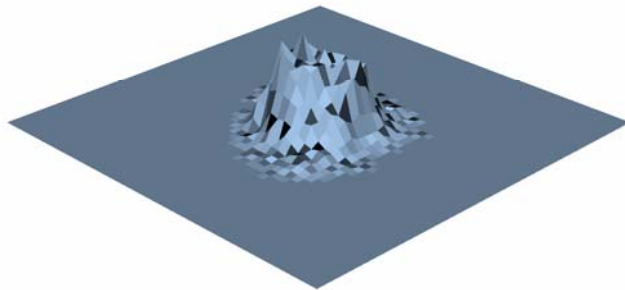
Case 2: All products have finite lifetime.

Divestment is captured by removing a product, and all its units, from the product portfolio when it has reached its lifetime. (A product's lifetime starts at the period when the first unit is added to the portfolio.)

Evolution of product portfolio shape

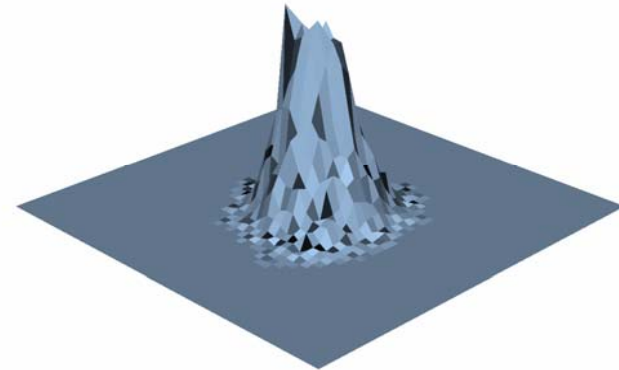
finite lifetime 1000

Collapse

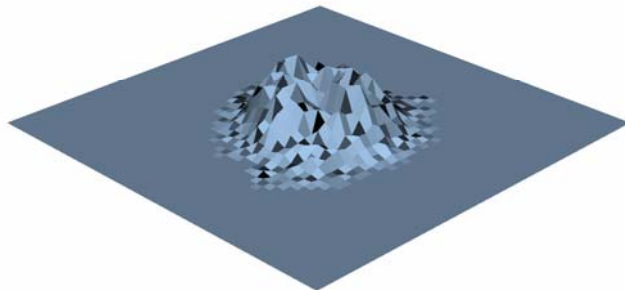


1500

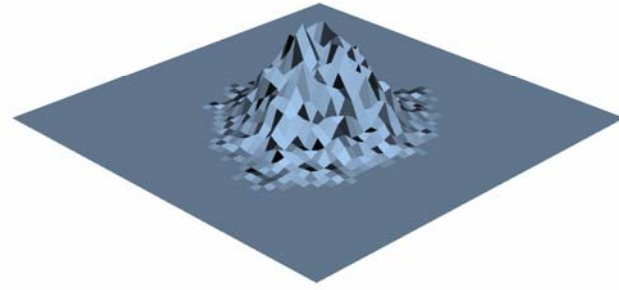
Resurrection



2000



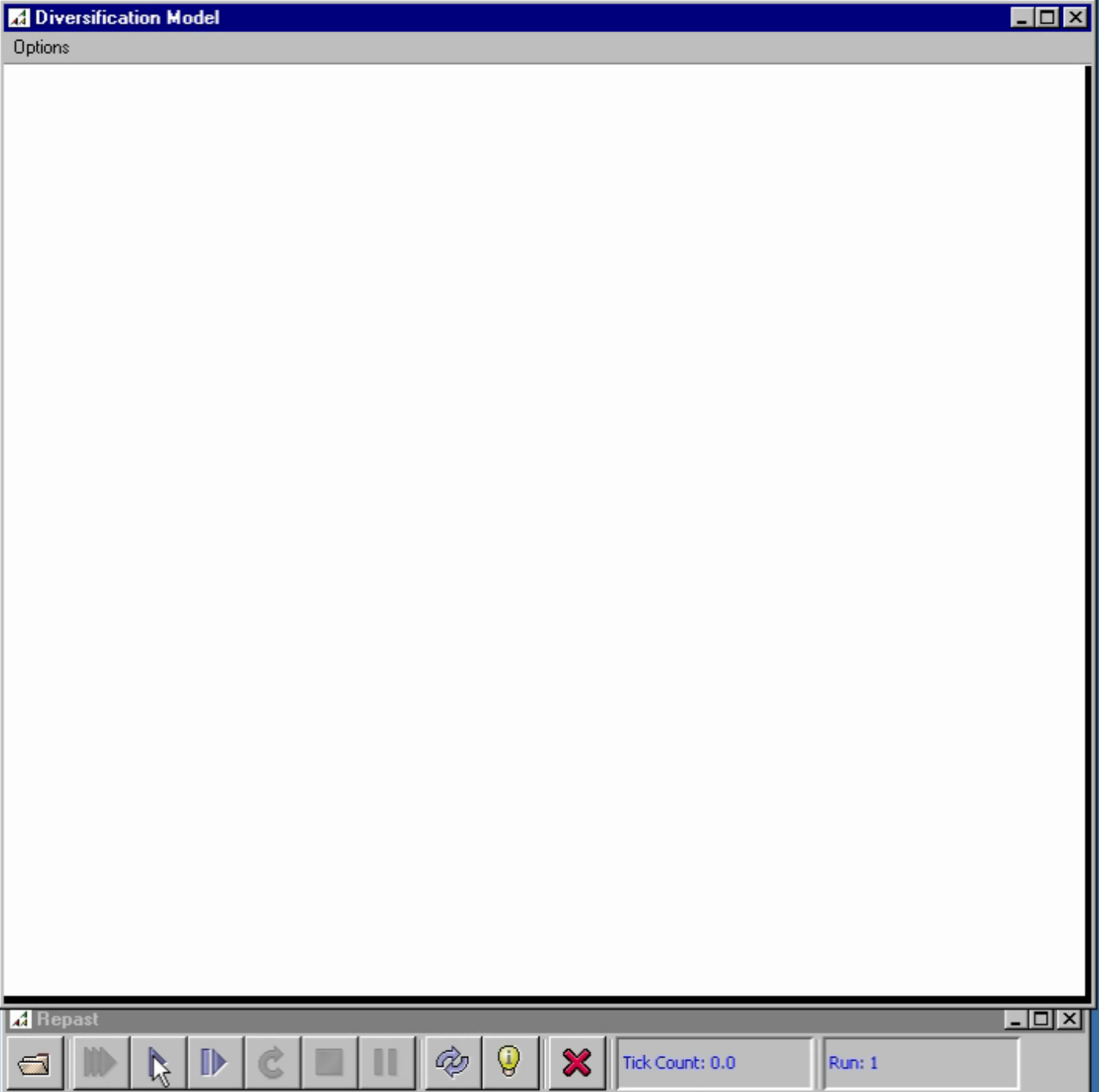
2500



3000

Evolution of portfolio product

- After initial collapses and resurrections the portfolio start to spread out and to desintegrate into a random pattern of diverging small clusters.
- Also, the clusters themselves come and go. The reason is that the core of a cluster is eliminated after the first products in the core of a cluster reach their limited lifetime.



finite lifetime = 100

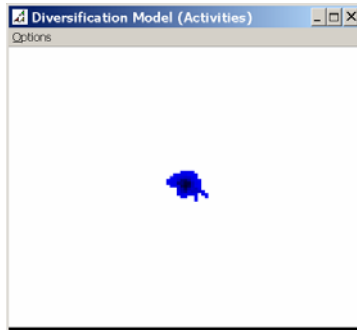
Evolution of portfolio product cohesion

finite lifetime = 1000

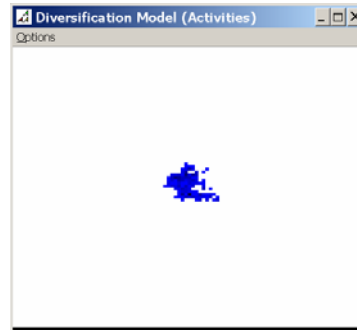


Evolution of product portfolio shape

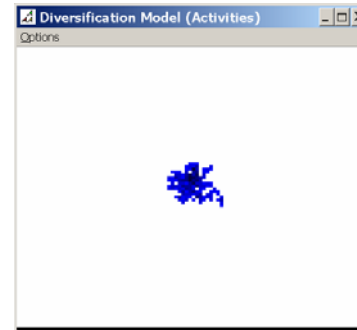
finite lifetime 1000



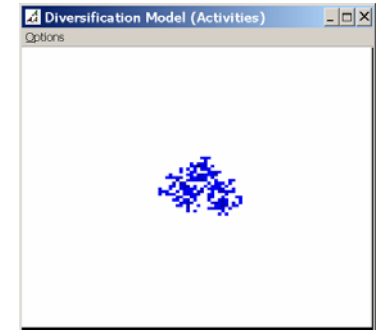
period = 500



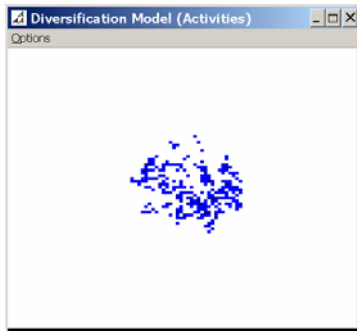
period = 750



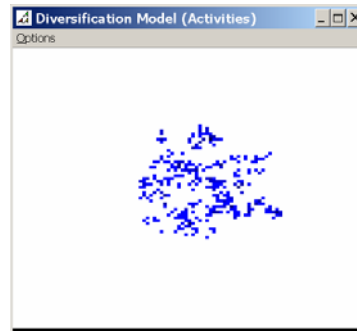
period = 1000



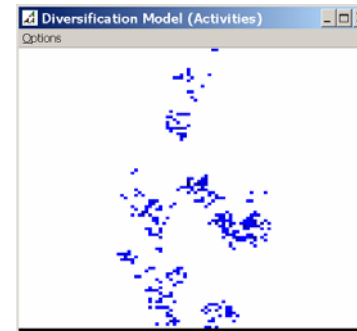
period = 2000



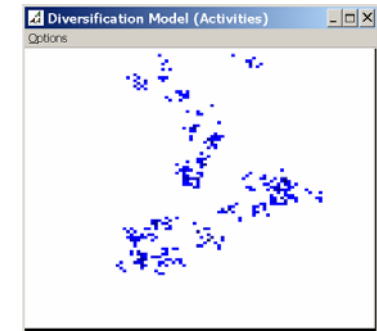
period = 5000



period = 10000



period = 50000



period = 150000

Case 3: Single origin constraint

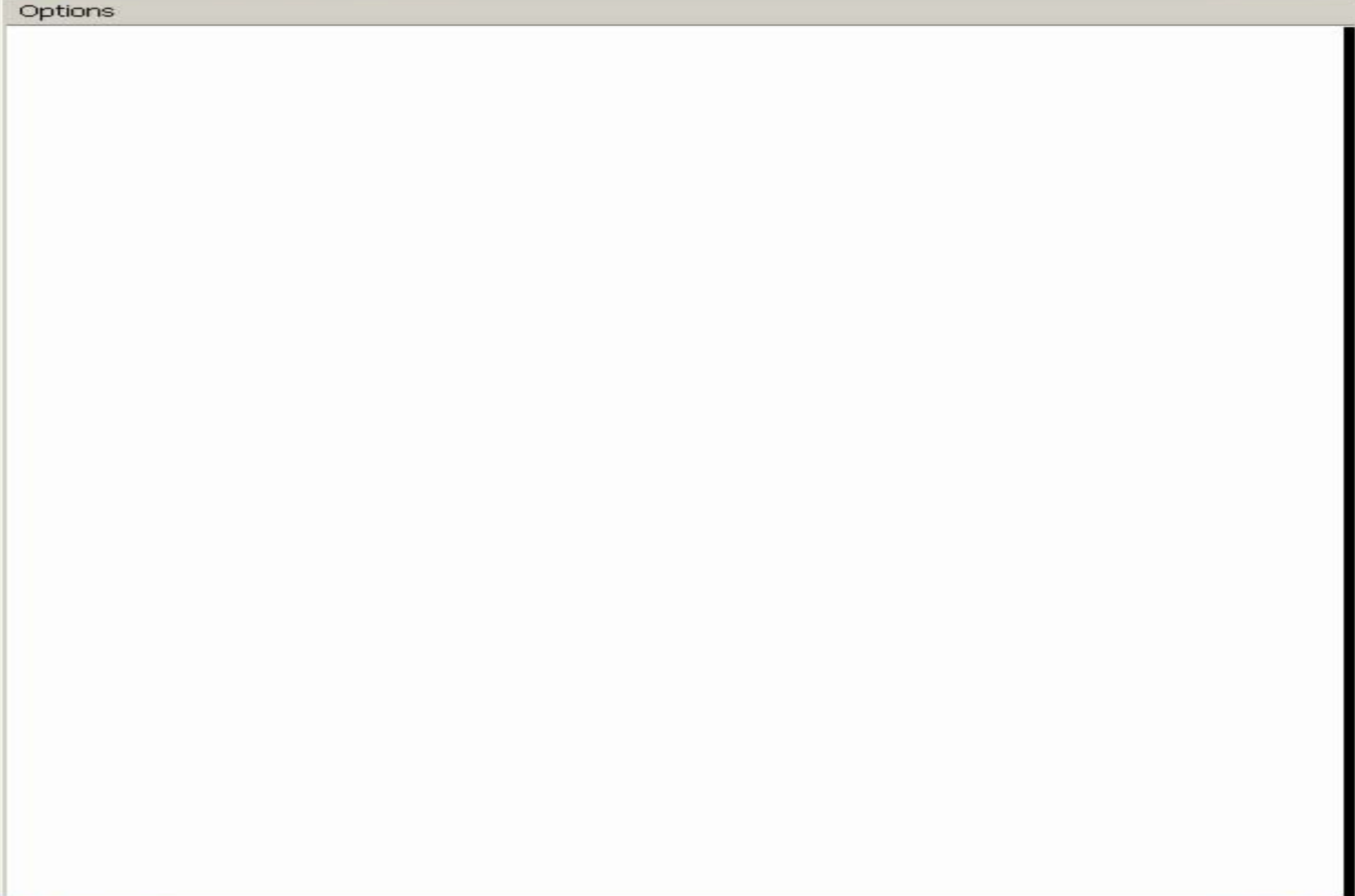
The single origin constraint entails that the product requiring the inputs of a cooperative's members will never be divested.



Tick Count: 0.0

Run: 1

Lifetime = 100, Single Source



Main result:

The product portfolio of corporations evolves into **unstable clusters of related products**, while the single origin constraint is responsible for pulling all products of a cooperative together in **one cluster**.

Next step:

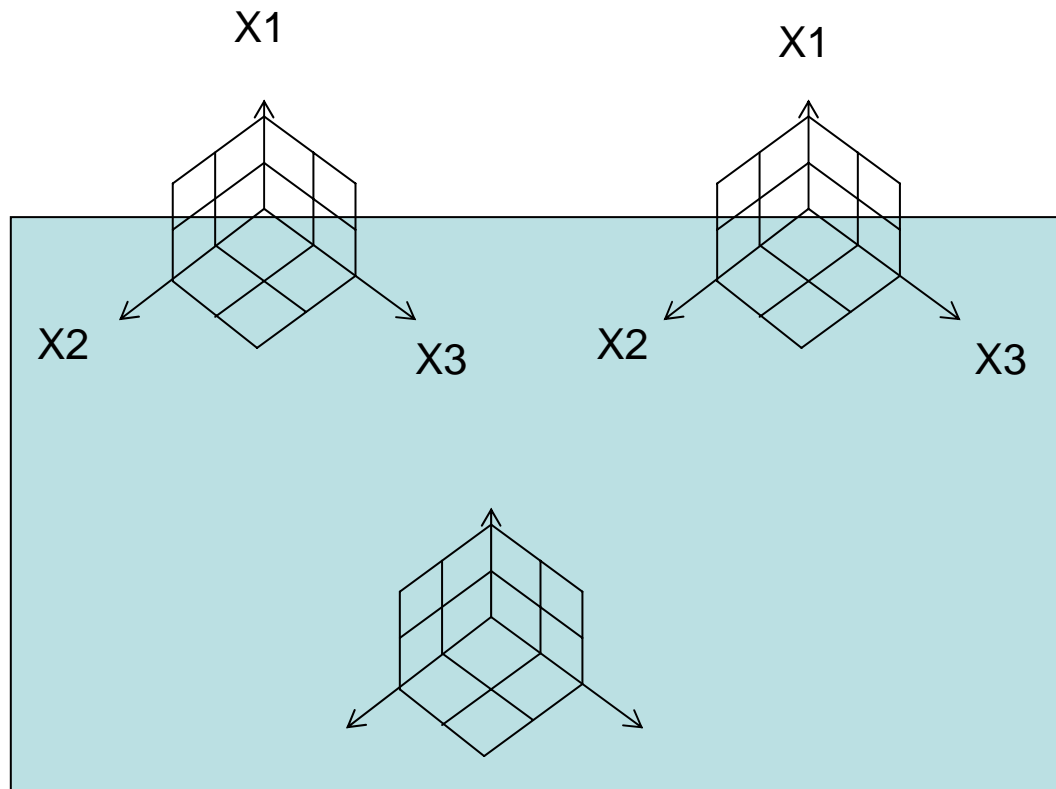
Competition, i.e. multiple portfolio's / enterprises.

5 Future research

Cooperative:

Firm
owned by
many independent suppliers / buyers.

A cooperative



Farmers

Processor

Research direction

Addressing the unique aspects of the member (firms),
compared to investors as owners of an IOF.



Managerial implications for cooperative leaders:

Develop positive externalities.