The Strategic Development of Irish Livestock Marts

T. Hennebry, E. Pitts and L. Harte.

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Summary

A study of co-operative livestock marts revealed that cumulative marts turnover decreased by 26% from 1990 to 1999: Commission income as a percentage of turnover increased from 2% in 1990 to 3.2% in 1999. However operating expenses increased by 25% from 1990 to 1999. Operating expenses have since 1997, surpassed commision income, thus putting co-op marts in a collective loss making situation from their mart activities. However overall profit from co-op mart societies (including profit generated from all business activities) almost doubled between 1990 and 1999. While overall profitability of livestock marts societies has increased, twelve of thirty nine marts were in a loss making situation in 1999. Four of these marts have been in a permanent loss - making situation since 1990. All loss making societies in 1999 have little or no involvement in non-mart activities and almost all operate from just one site. In general, the large diversified societies are showing profitability.

A number of strategic alternatives to deal with their situation were placed before mart executives. A diversification strategy is by far the most likely strategy to be adopted by marts for the future Most marts are unlikely to consider merging with other societies. Most marts have no plans to downsize and exit from the industry is not considered an option by any society. There is a recognition that there is an urgent need to rationalise the industry, but this strategy is likely to meet with a strong resistance from marts . A problem with rationalisation is that there are no incentives to make this strategy a reality. On the one hand, management would be reluctant to follow this approach, as it may be perceived to reflect badly on their own performance or may result in

them being forced to seek alternative employment. On the other hand, the shareholders have little to gain and much to lose if the mart closes.

Projections of past trends and impact of new policies would suggest continuing decline in turnover and profitability in the co-operative mart sector. Rationalisation is therefore absolutely essential. The industry cannot sustain the present number of marts. Diversification seems the most obvious option for the future of the industry. In general marts that have diversified are profitable and there is no reason why this trend cannot continue into the future.

Introduction

The environment in which the co-op marts operate has changed substantially since the 1970's and 1980's. Changes in the marts external environment (including changes in livestock production systems, the regulatory environment and two rounds of CAP reform) have reduced price levels and increased direct payments. In addition, marts are operating at much higher cost levels due to increased computerisation, upgraded facilities and services.

The volume of business conducted by livestock marts over the last decade has declined considerably, with reduced interfarm transfers of cattle and increased direct sourcing of animals by slaughter factories, live exporters, supermarkets etc. Livestock marts, having built up considerable good-will and farmer confidence, expertise, and financial resources, have now reached a cross-roads in their development.

This study investigates the effect of the various forces impacting on the cop-op marts and examines a range of strategies for the future. Private marts are excluded from the study due to the difficulty in acquiring information and time limitations involved.

Objectives of the study

The objective of this study is to develop a set of strategies which can be applied to the co-op mart sector. The study examines:

- the factors underlying why there has been a decline in profitability and overall viability of the marts over a ten-year period, from 1990 to 2000
- the relevance of strategies developed from the business literature review for the co-operative mart sector in Ireland.

Literature Review on Business Strategies

Porter proposed three alternative strategies in order to defend against the external forces impacting on the competitiveness of a business. These are a cost leadership strategy, a differentiation strategy and a focus or niche strategy.

While the above strategies are general approaches to strategy formulation, there is limited literature on the strategic approaches in declining industries. One author has suggested five different strategic solutions for declining industries. These are, increase the investment in order to seek market dominance; hold investment steady; shrink selectively, harvest and divest.

Other writers suggest the following alternatives (a) diversification (b) vertical integration and (c) horizontal integration, for firms wishing to improve their competitive position.

There are a number of ways in which the firm can diversify, including the development of new businesses internally, joint ventures with other companies, and acquisitions of firms in other industries.

Vertical integration refers to the process by which a firm controls the entire cycle for a product or service from source of supply to a ready market for their outputs.

The third strategy, horizontal integration, involves merging with or acquiring similar or unrelated businesses.

The co-operative organisation form is distinct from other types of organisation. Its underlying motive is to provide a service to its customers, who are its shareholders and not solely to pursue profit .

Studies have shown that co-ops most likely to diversify are those, with large turnover and membership. Internal motivations for diversification in co-ops include reducing risk, improving the utilisation of the co-ops existing resources and meeting the needs of the patrons. Some writers have suggested that diversification is more in the interest of the management of the co-op rather than that of the shareholders.

The following hypotheses derived from the literature on co-operatives and on strategy were tested in the course of the study:

Hypothesis 1: Co-operative marts would favour strategies of diversifying into related non-mart activities.

Hypothesis 2: Co-operative marts would favour horizontal integration, by merger, but may encounter difficulties in getting willing targets.

Hypothesis 3: Co-operative marts would not favour either upstream integration into farming or downstream integration into meat processing.

Hypothesis 4: Co-operative mart enterprises would not favour an exit strategy

and

Hypothesis 5: Co-operative marts would not be supporters of a rationalisation programme.

Methodology

The methodology used in this study consists of both primary and secondary research. Data on the co-operative marts societies available from the Registrar of Friendly Societies were analysed in detail. A sample of thirteen co-op marts was chosen based on their turnover and geographical location. A minimum turnover figure was set at £6 million and there was no maximum. Five major mart societies and eight others were included. The development of these societies was analysed in detail and in-depth interviews were carried out with senior executives to assess reasons for past performance and likely responses to future scenarios.

Face to face interviews were conducted over a six – week period in May- June 2001 at the premises of each of the thirteen co-op marts included in this study.

Results

(a) Financial Performance of the Co-op Marts, 1990-1999.

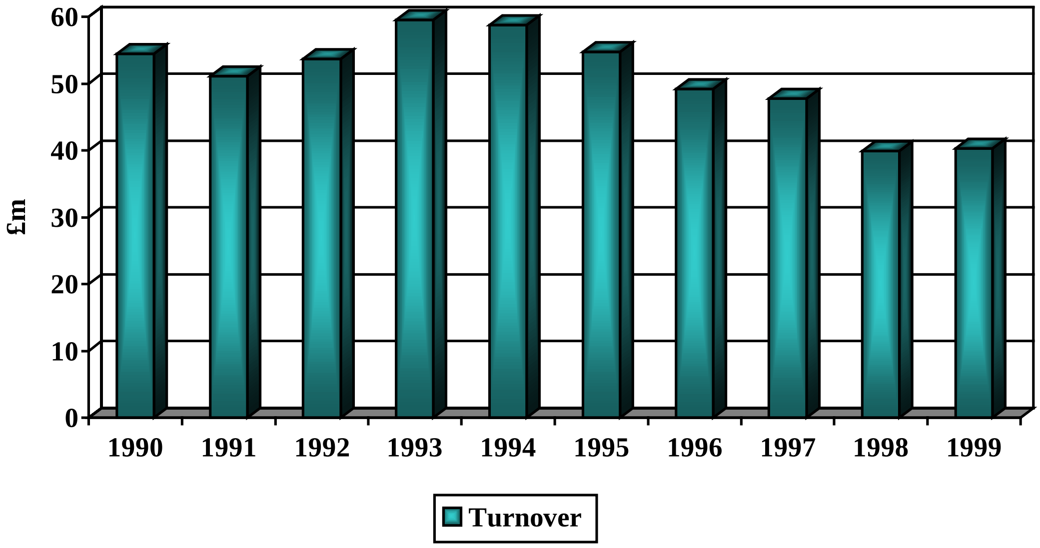
The analysis below is of the financial performance of 39 registered co-operative mart societies. It was intended to have complete coverage but one of the larger co-op societies has been excluded due to the fact that the accounts have not been broken down in such a way to enable the author to ascertain the contribution which the mart is making to the overall business. Three other societies have been excluded as they are not officially registered as co-operatives and therefore, no data was available from the Registrar of Friendly Societies.

ICOS has previously conducted a financial analysis of the co-op marts. The ICOS analysis covers the period up to 1998. The analysis here covers the period from 1990 to 1999 inclusive.

The analysis begins with the turnover of the co-op marts. Turnover in this context includes all sales of the mart. The analysis proceeds with a synopsis of the commission income earned from mart activities and the operating expenses associated with mart operations. A comparison of the commission income and operating expenses over the ten-year period is then conducted. The analysis concludes with a calculation of the profitability of the co-op mart societies. Profit here is defined as all income less all expenses and the net profit figure is arrived at after taxation has been accounted for.

Cumulative turnover decreased by 26% from £544m. in 1990 to £402m in 1999.

Figure 1.1 Co-op Mart Turnover, 1990-1999



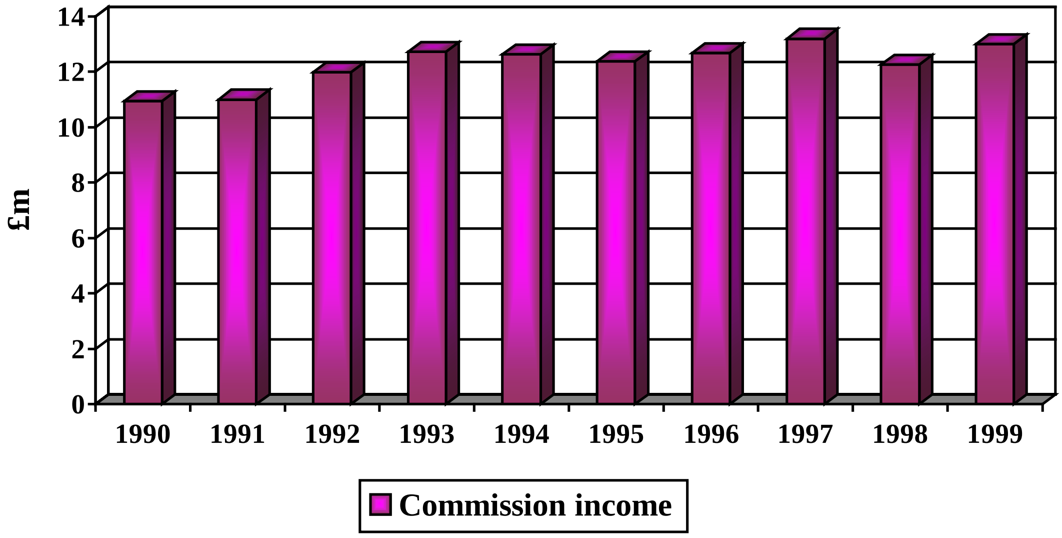
- The average turnover for each mart society decreased from £14.3 million in 1990 to £10.6 million in 1999. However, turnover ranged from £104,500 to £102,014,644 in 1990 and from £55,600 to £64,600,000 in 1999.

- Total commission income increased by 18.7% from £10.9 million in 1990 to £12.9 million in 1999 (see Figure 1.2)

- The average Commission income per mart society increased from £280,664 in 1990 to £333,273 in 1999. The commission ranged from a minimum of £8,518 to a maximum of £2,112,550 in 1990, and from a minimum of £21,675 to a maximum of £2,456,973 in 1999.

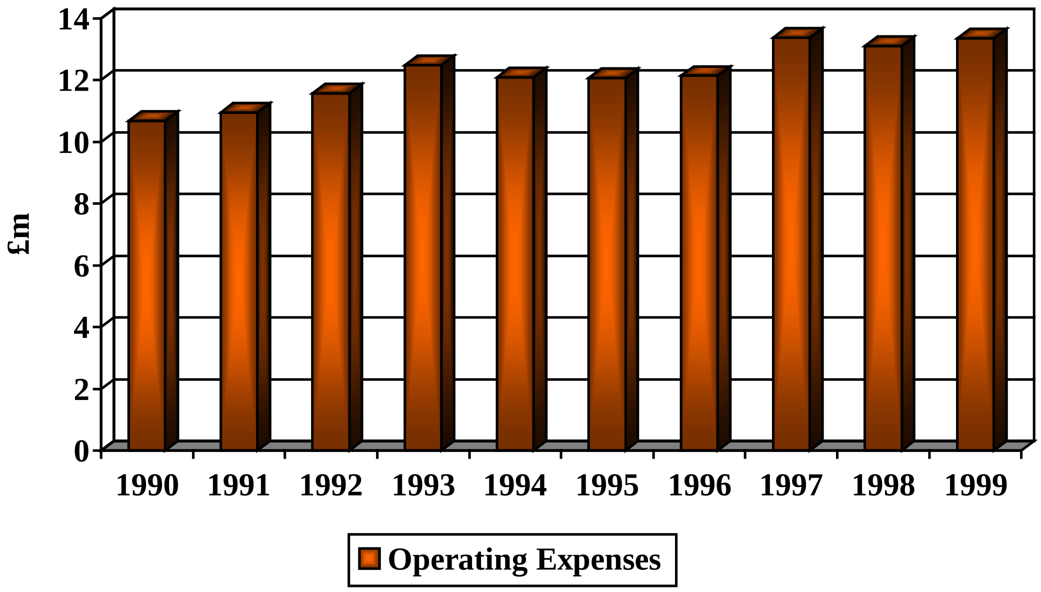
- Commission income charged as a percentage of turnover has increased from 2% in 1990 to 3.2% in 1999.

Figure 1.2 Commission Income, 1990-1999



- Operating Expenses increased by 25% from £10.7 million in 1990 to £13.4 million in 1999 (Figure 1.3).

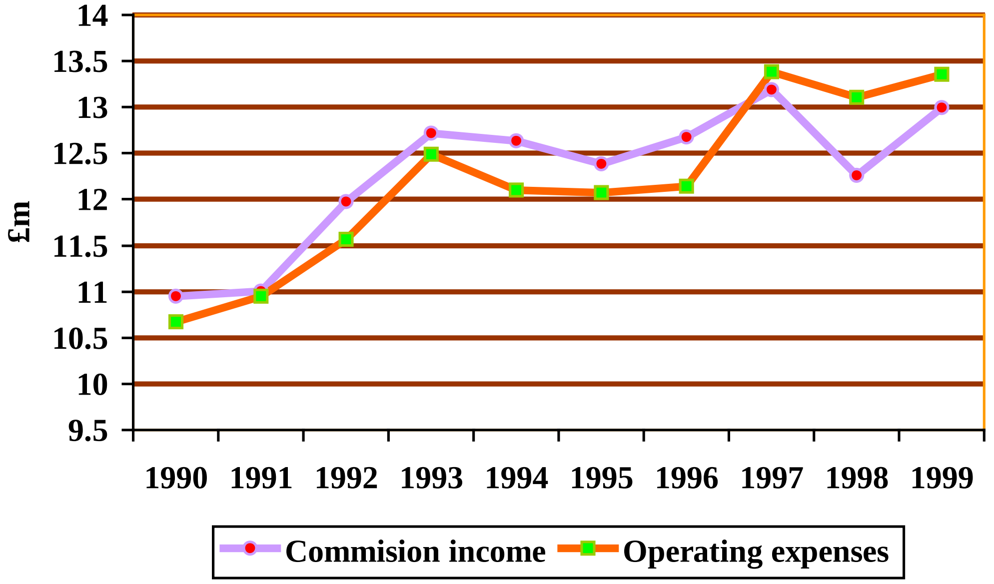
Figure 1.3 Operating Expenses, 1990-1999



- The average operating expenses per mart society have increased from £273,657 in 1990 to £342,358 in 1999. The operating expenses have ranged from a minimum of £3,075 to a maximum of £2,066,592 in 1990 and from a minimum of £27,684 to a maximum of £2,402,439 in 1999.

- Operating expenses have risen to such an extent over the 10 year period that for the first time in 1997, they surpassed commision income. In 1999, operating expenses remained higher, thus putting co-op marts in a collective loss making situation.

Figure 1.4 Commission income vs Operating Expenses, 1990-1999

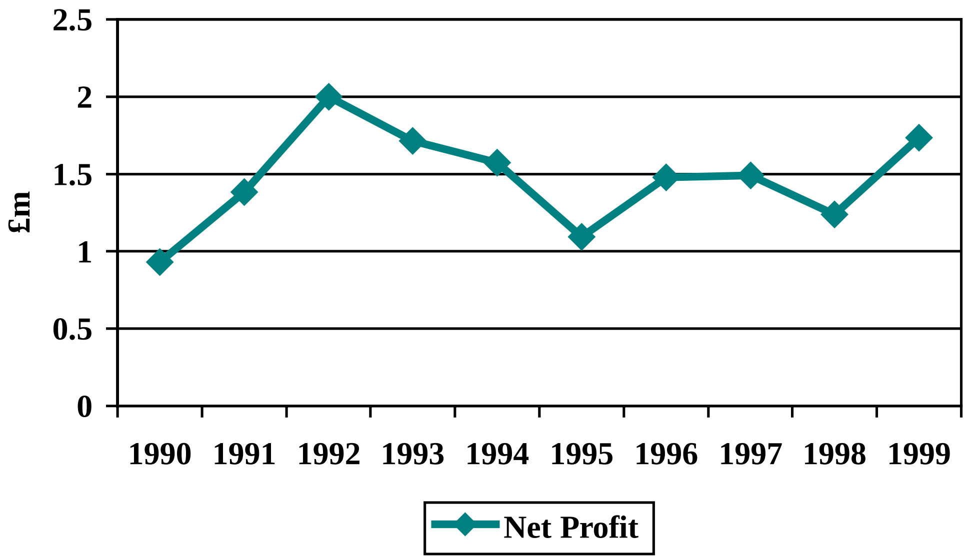


- Figure 1,5 shows the levels of net profit of all 39 co-op mart societies. Net profit includes profit generated from all business activities carried out by the co-operative and not just the mart (as in Figure 1. to 1.4)

The net profit almost doubled between 1990 and 1999, increasing from £0.93 million in 1990 to £1.73 million in 1999. Profitability rose rapidly up to 1992.

Following the CAP Reform of 1992, profitability began to fall sharply reaching its lowest point in 1995. It rose again in 1996, levelled off in 1997 and fell again in 1998 despite the peak in cattle numbers in the country. In 1999, profits rose

Figure 1.5 Mart Profitability



again and it was generally regarded as a very good year for the marts.

While in overall terms, profitability of livestock marts has increased, twelve of the thirty nine marts were in a loss making situation in 1999. This represents just over 30% of all the co-op marts. Four of these marts have been in a permanent loss - making situation since 1990. Two of these marts are located in the south - west while the other two are in the west and north west respectively. Three of these marts are not involved in any outside activities, while one mart in the west has a slight involvement in property sales but is finding it very difficult to break into the market. All are societies operating from a single site.

Of the eight other non-profit making marts in 1999, four are in the west, two in the south west, and two in the south east. Seven are single mart sites while one is a multiple site society. All have little or no involvement in non-mart activities.

In general, the large diversified societies are showing profitability. In general, the large diversified societies are showing profitability. While the graph indicates that mart profitability is also influenced by changes in the market for livestock, it is also true to argue that those who are generating the greatest profitability are those who are increasing their non-mart income.

The three multisite societies in the south have shown the highest levels of profitability over the ten years. All are diversified in some form with property selling being the main income earner.

Survey findings

Thirteen co-operative marts were studied in various locations around the country.

Table 1. 1 Number of Cases in the Sample by region

Province	Number in the sample	Total number of marts
Munster	5	21
Leinster	3	5
Connaught/ Ulster	5	11

The study sample represents 53% of the total number of co-op marts in the country but a considerably larger percentage of cumulative co-operative turnover.

Throughput : In general each mart has suffered a loss in throughput in each of the livestock categories, calves, other cattle, sheep and pigs. The main reason advanced for the decrease in pig numbers is the decline in the number of farmers involved in pig production. The decrease in calf numbers has been particularly felt in the traditional dairy areas, with the decrease in the number of dairy farmers identified as the main reason for the decline. The decrease in cattle numbers is associated with the changing patterns in farming; especially the increase in part-time farming and the resulting tendency to rear beef animals from calf to beef. In addition the availability of certain premia is also encouraging farmers to hold on to their animals longer.

Financial Performance Turnover has decreased in nine marts, with just four marts showing an increase. All those, which showed an increase, were single mart societies. The market share, as judged by the managers, increased for all the societies displaying an increase in turnover. Decreases in market share were generally associated with the larger societies.

Operating expenses increased in all but two marts. Labour costs, insurance and rates were identified as being the major sources of increase in operating expenses. Commission and entry fees have also increased in most marts over the ten - year period. Two marts, who have not changed their commission charges, are the only societies who have suffered losses in mart income for each consecutive year of the study.

Perceptions of the commercial environment

Marts perceive themselves as operating in a very hostile environment. Various Department of Agriculture rules and regulations have been identified as being the strongest influence on trade in the marts. Included here are various premia schemes, (especially the slaughter premium, enticing farmers to take animals to finish), tightening of movement following from TB and Brucellosis regulations, the BSE crisis and the Foot and Mouth crisis.

Another important factor is the changing profile of farmers. There is an increase in the number of part-time farmers and many smaller farmers are exiting the business. Younger farmers are looking toward alternative methods of selling. There are now more selling options available to the farmer reducing the reliance on the mart. In addition the projected decline in livestock numbers is also expected to impact severely on the marts.

Those most likely to consider evening sales are the single site societies. Societies with a number of mart sites or single marts that are at the top of the scale in terms of turnover are not likely to become involved in evening sales.

The main strengths perceived of the mart system are the tradition in livestock selling, the guarantee of payment, efficient staff, the reliability of weights, the provision of good facilities and the competitive trading environment.

The main weaknesses of the system are, the time wasting involved and rising costs.

<u>Future Strategies</u>

Twelve marts are involved in some form of non-mart activity.
Eleven marts expressed a definite interest in expanding their activities. Property selling seems to be the most popular choice. Non-mart activities contribute between 90-100% of gross profit in six of the societies. This group includes the four largest co-op mart groups in Ireland.

Growth in the core livestock mart business is very unlikely to happen. A diversification strategy is by far the most likely strategy to be adopted by marts for the future. Many of those who are likely to diversify are already heavily diversified. This category includes three major co-op mart societies. Those who are not considering diversifying express the fear of losing focus on their core business and the fear of entering into businesses of which they have no expertise.

Most marts are unlikely to consider horizontal integration . Two main reasons were advanced. The first refers to the fact that they wouldn't like to merge with or acquire a company that is less successful than they are. Secondly, all refer to the fact that their boards of management are unlikely to accept such a move, not wanting to relinquish or share control. The two marts who expressed an interest in merging, felt that it would make the company financially more secure and eliminate competition, thereby, increasing market share.

Most marts have no plans to downsize, fearing they would be worse off if they downsize. Those most likely to consider this option are the larger co-op societies.

Exit from the industry is not considered an option for any society. The larger societies are already rationalising their existing sites. While all marts agree that the industry needs to be rationalised, none are willing to become part of the process. The main advantages associated with rationalisation are that it would make existing marts more competitive and reduce staff costs. The main disadvantages are that it would negatively affect many businesses in the market town and farmers would also have to travel further to the mart, and may instead avoid the marts.

Implications

The hypotheses of the various strategy alternatives as suggested in the theory are now compared with the real situation.

The first hypothesis predicts that co-op marts will favour strategies of diversifying into related non-mart activities. This appears to be a very likely strategy for the future of co-op marts in Ireland. Both large and small co-op marts express similar levels of interest in diversifying their activities. There is a belief in the mart industry that greater diversification away from the mart itself is likely to yield increased profitability and put the co-op marts in a much better financial position.

Most marts have accepted that concentrating on mart activities alone will not yield significant returns for the industry. The larger marts are likely to find it easier to diversify than the smaller marts, due to their larger capital bases.

However, the smaller marts also acknowledge that this is the way forward for the industry, and see it as a necessary step if they are to remain viable in the future.

There will not be a great urgency surrounding diversification for private marts. The difference between the co-op marts and the private marts is that the co-op marts are diversifying in the interest of maintaining their viability and improving their profitability, stemming from a downturn in their mart business. It would be expected that if private marts were experiencing such difficulty, they would more likely exit the industry and benefit from the sale of their capital assets.

Theorists also suggest that related diversification is likely to be more profitable than unrelated diversification. This view is likely to hold true, as the greatest opportunities will be created for marts that can utilise their existing resource base and skills, rather than engaging in activities in which they do not have the required skills.

The second hypothesis predicts that co-op marts would favour horizontal integration, by merger, but may encounter difficulties in getting willing partners. This hypothesis does not fully hold with the practical situation. In general co-op marts are unwilling to take part in this process, whether they are the target or whether they are targeting another mart. Given the co-operative structure, there is unwillingness among board members to share or lose control.

Co-op marts most likely to consider this strategy will be those who are performing very poorly in comparison to the other marts. However, as the theory suggested, they will have difficulty in sourcing potential partners. Other more successful marts are less likely to consider merging with or acquiring a mart which is less successful than they themselves are.

The third hypothesis predicts that co-op marts would not favour either upstream integration into farming or downstream integration into meat processing. This situation will likely remain for the future

The fourth hypothesis predicts that co-op marts would be reluctant to consider an exit strategy. Co-op marts are indeed very unwilling to leave the industry. It would be expected that private marts would leave the industry at a much faster rate than co-op marts.

The fifth hypothesis predicts that co-op marts will not support a rationalisation process. The theory has outlined a number of drivers of the rationalisation process, all of which are applicable to the co-op marts sector. There is a recognition that there is an urgent need to rationalise the industry, but as in the past this strategy is likely to meet with a strong resistance from the marts sector.

The issue with rationalisation is that there are no incentives to make this strategy a reality. On the one hand, management would be reluctant to follow this approach, as it may be perceived to reflect badly on their own performance or may result in them being forced to seek alternative employment. On the other hand, the shareholders have little to gain and all to lose if the mart closes. In essence the marts provide a safety net for shareholders and provides them with a 'shop window' facility in which to value livestock. Even shareholders, who do not use the mart facility, have a vested interest in its continued existence because of its price making function.

Discussion and Recommendations

Times have changed dramatically in co-op marts with rising costs and declining profitability. There are now fewer farmers in Ireland, and many are now taking animals from calf to slaughter, cutting out buying and selling. Cattle numbers are projected to decline.

A number of questions must be asked. What do marts need to do in order to survive in the long term? What kind of initiatives need to be taken? In an attempt to answer these questions, a look at a future scenario (for ten years from

1999 to 2008 inclusive) for marts based on a number of assumptions is undertaken. These assumptions are:

1. Turnover will decrease by approximately 26% over the ten years as it did between 1990 and 1999.
2. Operating expenses will increase by 25% as between 1990 and 1999.
3. Employment in primary agriculture will decrease by 2.1% per annum as between 1992 and 2000.
4. Cattle numbers will decrease significantly as projected by FAPRI Ireland.
5. There will be continual changes in patterns of behaviour from buyers and sellers.
6. There will be an increase in direct selling.

These assumptions imply dramatic changes will need to take place in marts sector for the future.

If turnover decreases by 26%, marts will suffer a decrease in sales revenue to £37.9 million Operating expenses will have increased to just over £16 million. Numbers employed in primary agriculture would be down to 96,000 and there would be approximately 8.4 million cattle in the country. The 2001 foot and mouth crisis established patterns of behaviour which will affect marts well into the future, with more farmers rearing animals from calf to beef, and increased regulation of dealers causing many to cease operation altogether. It would also be expected that there would be an increase in direct selling, with the changing structure of Irish agriculture where there is an increase in the number of part-time farmers.

One thing is clear, no mart will be able to sustain the losses in profitability which would result if the above assumptions become a reality, unless there is an increase in the value of their capital base. Inevitably there will be an urgent need to rationalise the industry. Private marts have the easier option. They can cash in their assets and leave the business. For the co-op marts it is not so simple and straightforward. They need to carefully identify the various options open to them while taking into account the needs of both shareholders and management alike, while not disregarding their core principles.

While recognising these issues, the industry cannot sustain the present number of marts. Therefore, rationalisation of the industry is vital for its future survival. Rationalisation of the marts business has been advocated by ICOS since 1992. Yet very little progress has been made in this regard. What has been occurring is that an increasing number of private marts are exiting the industry. Any co-ops that have been rationalising have being doing so within their own organisation by decreasing the number of sites, which they operate. However, this is not enough. Certain marts will need to leave the industry altogether. There will not be enough business for all to survive if change doesn't occur. Many marts are already operating in a loss-making situation. There is no expectation that marts will recover the levels of profitability they experienced in the 1980's. There are too many negative features impacting on the business to justify all remaining in the industry.

While recognising that there is a need to rationalise the industry, there is the possibility that this could also be to the detriment of the industry. If twelve regional societies remain, as advocated by ICOS, farmers will have to travel longer distances, generating extra expense and more consumption of time. They may instead choose to ignore the marts altogether and sell from the yard.

While rationalisation is very necessary for the future survival of the industry, there is, as already mentioned little incentive to make this happen.

If all the above assumptions become a reality,, the marts that remain in the industry will be faced with two options if they are to survive in the long term. They can either eat into their existing capital base or else they can subsidise their income through diversification into other activities.

Consuming the existing capital base will be unsustainable in the long term. Diversification seems the most obvious option for the future of the industry. In general marts that have diversified are profitable and there is no reason why this trend cannot continue into the future. Diversification activities have been accounting for an increasing proportion of the gross profit of many marts.

Diversification may well be the best option for the future in terms of increasing revenue. However, marts contemplating this strategy must do so with extreme caution and choose alternatives carefully. We need only take a look at what happened in the past to realise the importance of this step. Efforts by two of the largest marts to become involved in the meat and live exporting business have not been very successful. Marts must decide which strategy suits their own particular needs, and not assume that activities pursued by other marts are always successful. Marts should engage in activities that complement their core business and present closer opportunities with the core customer base.

Single site co-op societies not intending to diversify might find that a focus strategy may not work in the longer term. Some are doing quite well at the moment, but it cannot be assumed that this trend will continue given the range of negative factors impacting on the business and the absence of any sort of optimistic outlook for the sector. There are too many negative factors impacting on the industry to justify concentrating on mart activities only. These marts should also consider diversifying for the future. However, if private marts continue to exit the industry at the current rate, then other marts may be able to increase their catchment area and thus market share will increase, leading to an increase in turnover and throughput.

Marts have traditionally shown a strong resistance to mergers and acquisitions, not wanting to share control or fear of losing control. The co-op marts are lagging behind the dairy co-ops in this regard. Dairy co-ops are more proactive in their involvement in mergers and accept it as a vital measure for their future success. Recent examples are the merger of Kerry Group and Golden Vale and the announcement in early February 2002 of Lakeland Dairies intention to purchase Bailieboro from Kerry Group. The co-op marts must follow the steps of the dairy co-ops if they are to strengthen their positions for the future. Mergers and acquisitions will enhance the ability of the marts to defend against market forces by putting the marts in a better financial position and increasing their market power.

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