

**COGNITION, AGENCY THEORY  
AND ORGANIZATIONAL FAILURE:  
A SASKATCHEWAN WHEAT POOL CASE STUDY**

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**by**

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## ABSTRACT

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**Cognition, Agency Theory and Organizational Failure: A Saskatchewan Wheat Pool Case Study.**

Supervisor: Dr. Murray E. Fulton

The Saskatchewan Wheat Pool went from being the largest grain handler in western Canada in the mid 1990s to undertaking a \$405 million debt restructuring in January 2003. Provincial grain handling market share had been over 60 percent for two decades prior to the Pool becoming publicly traded in 1996. With the share conversion, the Pool began a capital expenditure program in an effort to adapt to industry deregulation and to compete with the multinationals that were entering western Canada. This program was not successful. SWP's long-term debt increased five fold over the period 1996–1999 and consecutive multi-million dollar net losses were incurred followed by the debt restructuring.

This thesis uses dominant logic theory and the principal-agent problem to analyze what went wrong at SWP. Theory suggests organizations faced with major industry change may have difficulty revising their dominant logic, which leads to organizational failure. Not only is there a tendency to hold on to established beliefs, but the creation of new beliefs is prone to error because of bounded rationality. The existence of a principal-agent problem can worsen an organization's ability to revise its dominant logic. Information asymmetry and the principal's trust of the agent can lead to inaccurate beliefs and ineffective strategies being approved.

The results of personal interviews with twenty-one past management and elected Saskatchewan Wheat Pool personnel and grain industry affiliates are presented and

analyzed in a case study format. The results suggest that deregulation of the grain handling industry and the anticipated arrival of multinational competitors pressured the Pool to respond quickly to major industry change. The Pool had difficulty revising its dominant logic; it retained outdated beliefs and accepted inaccurate new beliefs. Interviewees described how some investments were built on erroneous beliefs and lacked complete due diligence. Evidence suggests the principal-agent problem was also at play. The need for confidentiality after the share conversion increased information asymmetry, and management took advantage of the board's lack of experience as investments extended beyond the farm gate. The principal-agent problem in conjunction with an inaccurate revised dominant logic is a reasonable explanation for the Pool's failure.

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## LIST OF ABBREVIATIONS

<b>ADM</b>	Archer Daniels Midland
<b>AWP</b>	Alberta Wheat Pool
<b>CTA</b>	Canadian Transportation Act
<b>CWB</b>	Canadian Wheat Board
<b>DBRS</b>	Dominion Bond Rating Service
<b>FRC</b>	Farmers Rice Co-operative
<b>HTE</b>	High throughput elevator
<b>JRI</b>	James Richard International
<b>LD</b>	Louis Dreyfus
<b>MPE</b>	Manitoba Pool Elevators
<b>NMP</b>	N.M. Paterson & Sons Ltd.
<b>NWT</b>	North West Terminal
<b>P&amp;H</b>	Parrish & Heimbecker
<b>PWT</b>	Prairie West Terminal
<b>RGA</b>	Rice Growers Association
<b>SAF</b>	Saskatchewan Agriculture and Food
<b>SWP or Pool</b>	Saskatchewan Wheat Pool
<b>SWT</b>	South West Terminal
<b>TSE</b>	Toronto Stock Exchange
<b>TVG</b>	Tri Valley Growers
<b>UGG</b>	United Grain Growers
<b>WCFL</b>	Western Canadian Fertilizers Ltd.
<b>WGE</b>	Winnipeg Grain Exchange
<b>WGTA</b>	Western Grain Transportation Act
<b>WIT</b>	Weyburn Inland Terminal

## CHAPTER 1: INTRODUCTION

### 1.1. Problem

Saskatchewan Wheat Pool (SWP) was for a long time the largest grain handler in western Canada, enjoying over 60 percent provincial market share from 1972 to 1992. In the 1990s, the Pool's dominance was eroded. This erosion was linked to a number of major changes in the agricultural industry and the grain-handling sector. These changes included the removal of the Western Grain Transportation Act (formerly the Crow Rate) in 1995, the subsequent removal of a prohibition on rail line abandonment, and the threat of entry of new competitors. At the same time the Pool was contending with the reality that a large portion of its membership was set to retire within the next decade requiring the repayment of \$100 million in equity. The Pool underwent an equity share conversion in 1996 to create a more permanent source of equity and allow it to respond to industry change. To adapt to these changes the Pool began an ambitious capital expenditure program to modernize its elevator network and to better position itself vis-à-vis the diversified multinationals – namely ConAgra, ADM, Louis Dreyfus and Bunge – that were entering western Canada. This program was not successful. The Pool's long-term debt increased five-fold over the period 1996–1999, its market share decreased significantly and it began incurring consecutive multi-million dollar net losses. Within four years the Pool's total debt was \$987 million (SWP Annual Report 2000). Both the Chief Executive Officer (Don Loewen) and Chief Operating Officer (Bruce Johnson) were asked to resign in June 1999; Board President Leroy Larsen retired the following year. Rapid divestiture from many of the investments the Pool had acquired post-share conversion could not bypass a \$405 million debt restructuring in January 2003. This

thesis analyzes why the Pool's investment decisions and strategies, in response to changing industry dynamics, led to organizational failure.

## **1.2. Existing explanations on the Pool's failure**

Literature exists on the reasons behind the Pool's organizational failure. Articles in popular farm press include a number of opinions as to why the Pool failed (Ewins 2002; Motiuk 2005). Co-op historian, Brett Fairbairn, is quoted as saying the Pool "tried to do too much in too short a time and tried to do the wrong things" (Ewins 2002). International investments in Mexico, Poland and England were described by David Schroeder, of Dominion Bond Rating Service, as being "out of [the board and management's] area of expertise" (Ewins 2002). Spending was described as uncontrolled and "undisciplined... [with] questionable financial due diligence" (Ewins 2002; Motiuk 2005). Blame for the Pool's failure is laid on both the board members and the management. Motiuk questioned "where was the board when SWP was making its dubious financial investments in Poland, Mexico and elsewhere...". In Ewins' article, both management and the board are described as lacking "proper experience" and "expertise in ...law, finance, marketing, and consumer demand" (p. 5).

Gatin (1999) gained insight into the impact of SWP's share conversion by conducting nine interviews with board members, management and industry affiliates. Interviewees were questioned on ten areas ranging from policy decision-making, the role of Class B shareholders, satisfaction with restructuring, changes in the Pool's focus, adherence to co-op principles and the Pool's vision for the future (p. 49). The interviews took place between February and June 1997, which was a high time for the Pool. Share prices were above \$15.00 and peaked later that November at \$24.20 per share. Revenues

exceeded \$4 billion and the Pool's mission statement was to become "the most dynamic agri-business co-operative in the world" (SWP Annual Report 1997). The interview responses reflected the Pool's successes, as board members and management showed enthusiasm and a positive attitude towards the share conversion and its impact on the Pool. However, the industry affiliates that Gatin interviewed felt the Pool had changed in an unfavourable light. Policy making decisions were said to now rest with the Chief Executive Officer instead of being formed at the grassroots level (p. 85). The industry affiliates felt the role of members and delegates was diminishing (p. 87) and that at times it seemed the "management [were] running astray with the company" (p. 90).

Lang and Fulton (2004) linked declining member commitment to the Pool's decreasing market and financial performance. Examples of declining member commitment spanned the last three decades. There was an increase in the number of delegate positions filled by acclamation suggesting members were less interested in being involved in the co-op. Farmer requests for differential pricing in 1982 were ignored, which may have contributed to lost market share as farmers began to patronize grain companies that were offering incentives and volume discounts. The Crow Rate debate further divided farmers and negatively impacted the loyalty of livestock producers who believed they would be better served by a removal of the Crow Rate, while the Pool lobbied for the Crow's retention.

### **1.3. Purpose and Objectives**

Since 2000, several large agricultural co-operatives in Western Canada and the United States, including Saskatchewan Wheat Pool, have battled impending bankruptcy or have ceased operations. Tri Valley Growers, AgWay, Farmland, and the Rice Growers

Association are all co-operatives from the United States that either filed for Chapter 11 bankruptcy protection or ceased operations between 2000 and 2002 (Anderson and Henehan 2002; Fairbairn 2003b; Fulton and Gibbings 2003; Keeling 2004; Sexton and Hariyoga 2004). Within Canada, Dairyworld Foods was bought out by Montreal dairy processor and cheese producer Saputo Inc. in February 2001 (Saputo website). In November 2001, Agricore, formed through a 1998 merger of Alberta Wheat Pool and Manitoba Pool Elevators, merged with United Grain Growers to form Agricore United (Agricore United website). It is worthy to mention that United Grain Growers is not without its own financial hurdles. UGG was a producer-owned co-operative that became publicly traded on July 28, 1993. In 1997, there was a failed attempt by AWP and MPE to takeover UGG, instead UGG entered an alliance that gave ADM 45 percent ownership in the publicly traded co-op (UGG 1997; Ewins 1997b).

The purpose of this research is to show why SWP failed financially. The main objective of this thesis is to determine how the Pool went from being a successful agricultural co-operative with a healthy balance sheet and over 60 percent provincial market share to incurring multi-million dollar net losses and nearly halving its market share all within one decade (1993–2003). Pool members, government, investors, financial institutions, and the co-operative sector have been looking for explanations as to how a viable and financially successful co-operative lost its market share and profitability.

Determining the origins of the Pool's organizational failure can lead to lessons learned for use by other co-operatives. Views on the changing dynamics of the grain industry, the Pool's response to those changes through its capital investments and the

decision-making processes on which the investments were based are required to determine the origins. Analysis of the decision-making processes and underlying assumptions for decisions may better inform other agricultural co-operatives facing similar circumstances as the Pool. Establishing if there is any connection between the decision-making processes in this co-operative and its organizational structure, governance and underlying culture may lead to suggestions for change among co-operatives of similar structure.

In Chapter 2, two propositions are put forward as explanations for the Pool's organizational failure. A case study approach is employed in this thesis to test the two propositions. Past management and elected personnel from the Pool along with grain industry affiliates were invited to participate in personal interviews and questioned on their thoughts and views about the changes in the grain industry and the Pool's responses to those changes. The identities of all the interviewees are remaining anonymous, which encouraged the interview participants to be more willing to partake in the interviews. The findings of the interviews are complemented with historic recounts of grain industry change and Pool performance.

#### **1.4. Organization of Thesis**

This thesis is composed of eight chapters. Previous studies on organizational and co-op failure are discussed in Chapter 2. The two research propositions are presented at the end of Chapter 2. A review of cognition and agency literature and a description of the theoretical framework are included in Chapter 3. The methodology of the thesis and corresponding interview results are described in Chapter 4. An historical review of the



western Canadian grain handling industry – with special focus on the players and regulations – is given in Chapter 5. Chapter 5 will also include the impact of deregulation that began in the 1980s and the other major industry changes. A review of the Saskatchewan Wheat Pool’s formation, market and financial performance, governance structure and responses to grain industry change from 1980 until 2000 is covered in Chapter 6. The interview responses are analyzed in a case study format in Chapter 7. The propositions are tested for validity at the end of Chapter 7. Chapter 8 concludes the thesis with a review of the linkages between the failed American co-ops and Saskatchewan Wheat Pool. The linkages will be used to offer lessons learned and recommendations for further research.

## CHAPTER 2: STUDIES OF ORGANIZATIONAL AND CO-OP FAILURE

### 2.1. Introduction

Although the focus of this thesis is co-op failure, it is valuable to look at research on the failure of non-co-ops. Organizational failure can be linked to an organization's cognitive models and the way it creates knowledge from information. Cognitive processes explicitly include a reliance on past actions and experiences to make decisions. Drawing from past successes and failures can cause problems if the new environment does not resemble any of the organization's or the decision-makers' past experiences. Major industry change is a prime example of where established knowledge and past experiences are less reliable for current decision-making. In addition, prolonged success can weaken an organization's capacity to recognize and react to change. The following examples show how successful organizations have failed under the pressures of industry change.

### 2.2. Research on Organizational Failures

Shimuzu and Hitt (2004) argue that continued financial success can reinforce the mindset and strategies of an organization, making an organization blind to needed change. An organization will proceed with similar strategies, views and decisions if these have proven successful multiple times over; in addition, deviation from these routines will not be welcomed. The downside of this behaviour is that managers can become insensitive to new information, preventing the organization from being able to recognize major changes on the horizon and the need to respond to those changes (p. 46). Long-standing success can build overconfidence and hubris in an organization, which

may result in substantial loss (p. 44). As an example, Motorola's success in analog cell phones resulted in management underestimating the potential for digital technology. Management "discouraged new investment to develop digital phones" because they believed the digital cell phone would be bulky and impractical (p. 46).

The idea of an organization being blind to change and unable to adapt to new industry practices is also shown by Sanderson and Taylor (1999). Sanderson and Taylor (1999) examine why successful companies that had been listed in the Times Top 1000 Companies in the 1970s were no longer operating by 1990 (p. 661). They conducted a case study on Dunlop Holdings, a once famous tire company. A series of unsuccessful decisions led to a steady decline in Dunlop Holdings' profits and market share from 1975 to 1985 and eventually it sold off all of its divisions (p. 665). Sanderson and Taylor's central thesis was that a company's culture impacts its view of the environment and filters what information becomes internalized by management and valued as knowledge. Information has to be within the scope of the management's past experiences if it is to be retained as knowledge.

Sanderson and Taylor (1999) relate culture to strategy by drawing from Johnson's (1992) dominant paradigm and Bettis and Prahalad's (1995; 1986) dominant logic. The dominant paradigm is comprised of the underlying values, strategies, and behaviours that control an organization's decisions. A dominant logic is an organization's lens on the environment that determines what is important. Sanderson and Taylor speculated that Dunlop Holdings had a dominant paradigm or way of looking at the world that prevented it from interpreting or valuing new information necessary for change. Dunlop Holdings

was bypassing important new information because this information was not closely enough linked with management's past experiences. As a result, the company was behind in innovations and was involved in an unsuccessful merger (p. 665). Money losing strategies were not altered; instead problems were attributed to inclement weather and unfair competition. This is a clear example of how the dominant paradigm prevented the company from adapting to new information. Inaccurate strategies prevailed because the new information, needed for adaptation, was outside the scope of management familiarity and therefore not applied.

### **2.3. Research on Co-op Failures**

Research on co-op failures aligns with the research on non-co-op failures. Three co-ops from the United States – Tri Valley Growers (TVG), AgWay and the Rice Growers Association – each have had articles written on their financial difficulties (Sexton and Hariyoga 2004; Anderson and Henehan 2002; Fairbairn 2003b; Keeling 2004). Each article chronicles the events and decisions that took the co-ops from being very successful to claiming bankruptcy or ceasing operations. Similar to Shimuzu and Hitt (2004) these articles reveal that co-ops that have had prolonged success can fail under industry change because they do not react effectively. Strategies and views built on success and overconfidence tend to be inaccurate after vast industry change occurs.

Fulton and Gibbings (2004) stress the importance of cognitive processes and effective knowledge creation for adaptation during industry change. They show how a co-op's "perspective and understanding of events" is connected with its performance (p. 172). Specifically, they review the circumstances that led two once successful co-ops –

AgWay and Farmland Industries Ltd. – to file for bankruptcy protection in 2002.

Parallels between AgWay and Farmland Industries Ltd. – heavy leveraging, numerous business lines, loss of member commitment, lack of oversight by board members, lack of separation between CEO and board, and problems restructuring or consolidating – are identified as contributing factors to the co-ops' failures (p. 173-174). These co-ops did not correctly interpret the changes or understand the events that were underway in their sectors, which led them to adopt unsuccessful business strategies (p. 176). The co-ops' cognitive structures did not accurately adapt to industry change. Fulton and Gibbings (2004) inclusion of the relationship between the board members and CEO as a factor in the co-ops' difficulties suggests the principal-agent problem may also have played a role in the failure.

Industry change tests an organization's ability to adapt effectively. Dominance and success within an organization were shown by Shimuzu and Hitt (2004) to cause blindness for upcoming change and hubris leading to failure. Besides inaction an organization may undertake unsuccessful strategies, which suggests the organization's dominant paradigm includes inaccurate views of the environment (Sanderson and Taylor 1999). When faced with rapid change an organization may either be too ignorant or too inexperienced to make the right decisions. Decision-making will also be negatively affected if there is a lack of experience and knowledge among the board members and management.

The articles on TVG, AgWay, and Rice Growers Association were reviewed for commonalities in the co-op failures. Eight common factors were identified and the general findings are summarized in Table 2.1. In Chapter 8, these co-op failures will be

compared against the case study results on the Pool's failure. Determining linkages between these co-op failures and the Pool's failure can lead to a better understanding of how and why co-ops can run into problems when faced with change.

### *2.3.1. Tri Valley Growers*

Tri Valley Growers (TVG) operated as a fruit cannery and tomato-processing co-op in the state of California for 37 years before it filed for bankruptcy protection in 2000. In terms of market dominance, Tri Valley Growers was the largest canner in California in 1998. Sexton and Hariyoga (2004) examined the co-op's operations and linked its failure to a series of unsuccessful strategies and missed opportunities in the tomato processing industry in the 1990s.

There was a state-wide shift in production locations for tomatoes and an increase in processing done at the production sites (Sexton and Hariyoga 2004, p. 21). Tri Valley Growers' plants were not geographically aligned with its producers resulting in higher shipping costs than its competitors. Tri Valley Growers was not geographically aligned with its producers because it had chosen to expand its operations over the years by purchasing failed co-ops and gaining their dispersed memberships. The co-op had nine processing plants in California and a reprocessing plant in New Jersey. Unable to make the necessary investments in plant modernization and relocation because the co-op was carrying a high debt-to-equity ratio, TVG missed out on the growing markets for salsa and barbecue sauces (p. 21). Rather than exiting the tomato business, which had been considered in 1994, a new focus was put on branded and peeled products where strong competitors already controlled the market.

**Table 2.1. Common factors among three co-op failures.**

	<b>Tri Valley Growers<sup>a</sup></b>	<b>Rice Growers Association<sup>b</sup></b>	<b>AgWay<sup>c,d</sup></b>
<b>Industry Change</b>	Shift in production areas; increased demand for pasta, salsa and bbq sauces; new processing technology	Declining government support; Domestic branded rice expected to grow; bulk export markets declined	Change in market conditions; Increased concentration in farming; Decline in pelleted feed demand
<b>Dominance</b>	California's largest canner in 1998; largest fruit processor in California	Controlled +70% of Californian rice acreage during 1970s and 1980s	Largest ag supply and marketing co-op in US during 1970s and 1980s
<b>Unsuccessful Strategies</b>	Purchased failed co-ops; Missed bulk paste market; underutilized plants; raised prices which declined sales	Involved in too many product lines; \$3 million loss after first year of long-grain premium program; Koreagate	Diversified where it had no previous experience; Belief that it could make any business work; Focus on size
<b>Member Loyalty</b>	Fruit producers upset that profits used to subsidize losing tomato division; growers not loyal	Producers sent bills in 1985; Membership decreased 94% in 14 years to 150 members	Loss of 23,000 members over 12 years; Lost connection with members when it closed stores
<b>Diversified</b>	Olives; Peaches; Pears; Tomatoes; 154 peeled products; 22 sauces; 61 pastes	Only major California producer of short, medium and long grain rice; bulk and retail markets	Retail/Grocery; Energy; Food Preservation; Futures Trading; Dairy; Seed; Leasing; Airlines; Refining
<b>Board Decision-Making</b>	"Blinded to economic realities"; Lacked strong business orientation and control over management	Lack of oversight, education and financial expertise; failed to supervise management; ill-equipped to scrutinize	2001 changed election process to gain "business-oriented" directors with "sound business skills"
<b>Management Decision-Making</b>	CEO made radical cost-cutting measures; Executives lacked food processing experience	Ineffective management; Did not fully evaluate decisions; remiss in planning for future contingencies	Selected and poorly executed wrong strategies
<b>Financial Trouble</b>	High debt-to-equity ratio prevented facility upgrades; long-term debt quadrupled; overpaid growers in 1998	Net profit declined 94% from 1981 to 1990; 12 D-E Ratio in 1989; missed payroll in 2000; unpaid debt lawsuits	Highly leveraged; Selling successful businesses to generate cash flow; Losses 8 out of 19 years, 1984 – 2002
<b>Failure</b>	Filed Ch. 11 in July 2000	Bankrupt in 2000	Filed Ch. 11 October 1, 2002

Source: <sup>a</sup> Sexton and Hariyoga 2004; <sup>b</sup> Keeling 2004; <sup>c</sup> Fairbairn 2003b; <sup>d</sup> Anderson and Henehan 2002

A new CEO in 1995 attempted to restructure Tri Valley Growers as a new generation co-op. Decisions by the new CEO to terminate knowledgeable plant supervisors and hire new executives with “little prior experience with co-operatives or food processing” were described as radical cost-cutting measures (Sexton and Hariyoga 2004, p. 23). Member loyalty had been declining on the tomato side of the co-op; it began to decline on the fruit side of the co-op as well because producers were frustrated that their profits were being used to subsidize the losses in tomato processing.

Sales began to decline and long-term debt rose; the CEO was fired in 1998 and the company was bankrupt before its official filing in July 2000 (Sexton and Hariyoga 2004, p. 23). Blame has been pointed at the co-op’s leadership, poor management decisions and its “failure to come to grips with the grower end of the tomato business” (p. 24). Blame has also been pointed at the board members. A former CEO of Tri Valley Growers and the CEO of Pacific Coast Producers were quoted in the article as saying the board “seemed blinded to economic realities” and was “lacking a strong business orientation”, respectively (p. 23).

### 2.3.2. *AgWay*

AgWay was the largest agricultural supply and marketing co-op in the United States during most of the 1970s and 1980s. It had been operating for 32 years when it filed for Chapter 11 bankruptcy protection on October 1, 2002. Anderson and Henehan (2002) point out “red flags” that signaled AgWay’s unsuccessful strategies and failing finances.



Anderson and Henehan (2002) noted that the co-op became caught up in the idea of being big because of “historic momentum” that started in the 1940s. The co-op’s size and power may have been the source for AgWay’s unrealistic attitude that it “could manage any type of business, even when others could not” (p. 3). An example of this unrealistic attitude was AgWay’s 1980 purchase of a fluid milk business. The co-op had no prior experience in the fluid milk industry and had previously vowed to remain out of the dairy industry. The authors go on to describe how the culture was instilled in the directors and management. This deeply rooted culture meant that “old traditions and strategies may have outlived their usefulness or detracted from their willingness to change” (p. 3). In the years prior to the bankruptcy filing, AgWay was highly leveraged and experienced net losses and numerous write-downs.

AgWay altered its method for electing board members in January 2001 in an attempt to gain more “business-oriented” directors with a “big picture view” and “sound business skills” (Anderson and Henehan 2002, p. 7). This reasoning suggests that the previous governance structure did not provide the required skill set. Outside directors were also introduced at this time, but they were not familiar with the agriculture industry and resigned in June 2002 (p. 7).

Anderson and Henehan (2002) concluded that determining what went wrong at AgWay involves looking at all the key players with influence on the co-op’s decisions and resulting success or failure (p. 11). When the accelerated changes in agriculture came about, AgWay was not prepared; the authors point blame at members for asking too much of their co-op, members influencing directors to avoid making tough strategic decisions, and management selecting the wrong strategies (p. 11).

Fairbairn (2003b) followed up on the work by Anderson and Henehan (2002) with detailed recounts of AgWay's efforts to increase in size and create new business lines under CEO, Donald P. Cardarelli (p. 5). Cardarelli wanted to grow the company and ensure profitability for the members. Fairbairn raised an obvious flaw; Cardarelli should have wanted to ensure profitability for the co-op and not its members (p. 7). From 1995 to 1998, AgWay reorganized its three agriculture components – AgWay Agricultural Products, Country Products Group, and AgWay Retail Services – through integration and revamping store appearances. AgWay then invested in natural gas, pathogen-free dairy heifer barns, dairy nutrients, food preservation products, produce operations, brokering and a new retail chain. Many of these investments were divested from in 2002 in an attempt to refocus and strengthen the co-operative (p. 15). Retail store closures resulted in declining membership because members lost connection with AgWay (p. 18).

### *2.3.3. Rice Growers Association*

The Rice Growers Association (RGA) was a marketing co-op for rice based out of California. In terms of market dominance, RGA was handling approximately 70 percent of California's rice crop in the 1980s. Its market share fell to five percent by 2000, a direct result of declining membership. That same year the co-op closed its doors after 80 years of business.

Keeling (2004) conducted a case study on RGA, including SWOT analyses on three major decisions and a comparison of RGA with its largest competitor, Farmer's Rice Co-operative. Keeling complemented this research by conducting personal interviews with management, employees and members of RGA. A mail-out survey to

determine why California co-ops have been struggling and ways co-ops could improve was also administered.

The co-op had a loyal membership until members were sent bills in the late 1980s to cover losses incurred by the co-op (Keeling 2004, p. 4). Membership fell from 2,200 members in 1986 to 250 members in 1993, to a low of 120 to 150 members in 2000 – a 94 percent decline in membership over 14 years. The co-op’s decision to issue bills to its members to recoup losses it had incurred had negative repercussions as member confidence and trust eroded.

A new CEO in 1985 attempted to shift RGA away from bulk rice to value-added markets that included strong competitors such as Uncle Ben’s (Keeling 2004, p. 17). Keeling mentions a “diversify or declare bankruptcy” mentality being at play within the co-op (p. 15). Management was openly criticized when it first began strategies to develop branded rice products; instead of re-evaluating their decision, management responded by saying, “those who succeed in business are the ones who innovate” (p. 19). Interviewees’ dissatisfaction with management was revealed in the survey portion of the interview; 96 percent of survey respondents agreed that “poor decision making by management” was a contributing factor to RGA’s failure (p. 42). One interviewee indicated that RGA was “focusing so much attention and money on penetrating the small differentiated market, [that] RGA likely would neglect its interest in the bulk market” (p. 16).

Responsibility is also put on the board members as interviewees felt the board failed to supervise management (Keeling 2004, p. 2). Former directors admitted they

were lacking management and financial expertise (p. 30). While former managers described the board as “passive and ill equipped to scrutinize the business decisions it was charged with” (p. 30). In the survey portion of the interviews, 74 percent of responses strongly agreed that RGA’s failure was partly due to a “lack of attention to cooperative issues by the Board of Directors” (p. 42).

#### **2.4. Propositions**

Cognition problems can be linked to the co-op failures discussed above. Each of the co-ops from the United States was once a dominant player in its core industry with diversified business lines. Industry change required the co-op’s to devise new strategies that proved unsuccessful and led to financial failure. In all three co-ops strategies were pursued under the helm of a new CEO. This is important because the CEO’s cognitive models play a role in the strategies pursued by the co-op. Each of the three co-ops discussed above puts responsibility for their failures on the board and management decision-making. Board member inexperience and ineffective management are also cited as reasons for the failures.

An organization’s managers, board members, and employees each have their own knowledge structures or cognitive models. These structures broaden and strengthen through life experiences and will include views, expectations, and beliefs. An organization will also have cognitive models built from business experiences and knowledge gained from its employees. An organization will rely on its cognitive models and the cognitive models of its key decision-makers to interpret information and make decisions. As new scenarios present themselves, an organization will search its

knowledge structures to find out how it had dealt with similar experiences in the past and then formulate a plan of action for the situation it is currently facing. However, if industry change is rapid the organization and its decision-makers may be unable to find past experiences in their cognitive frameworks that correlate with the current situation. In such a situation the views and beliefs of new senior managers may hold particular prominence, particularly if they appear to be part of a well-thought out new vision of the industry and the organization's place in the industry.

In some instances, organizations that have had long-standing success may become too accustomed to a way of thinking so the need for change is overlooked. The organization instead continues with views and strategies that are no longer appropriate for the new environment in which it operates. In either of these two cases, the organization's inability to effectively respond to the new developments within its industry can lead to organizational failure. Tri Valley Growers continued with its losing tomatoe processing division; AgWay carried an attitude that it could make any business work; RGA ignored criticism and continued a strategy to develop branded products that competed directly with well-established Uncle Ben's.

Governance issues also play a role in an organization's strategies and decisions. The co-op articles identified that board members lacked the required skill set to evaluate business strategies and monitor management. Board members are charged with overseeing management; they must monitor management and be able to properly assess investment proposals. The relationship between board members and management is important; if board members are passive and management is aggressive the balance of power can shift and the board can lose control.

Based on the experience of the American co-operatives, two propositions are put forward as explanations for why the Pool experienced organizational failure. Each proposition is tested for validity by finding supporting or refuting evidence in the interview responses received from the twenty-one personal interviews conducted with former Pool management, former SWP elected personnel and former grain industry affiliates.

#### *2.4.1. Proposition 1*

If an organization is locked into a way of thinking or is unfamiliar with its new operating environment it may be unable to effectively respond to new threats and opportunities. Another term for an organization's "way of thinking" is its "dominant logic". Over time successful strategies, standard operating procedures, and business models become embedded in an organization and represent the dominant logic (Bettis and Prahalad 1995; Prahalad 2004). The dominant logic assists with cognition and includes the past experiences of the organization as well as the past experiences of key decision-makers. There will be key decision-makers that can influence the decisions of an organization because of their charisma or strong-will. When the environment undergoes rapid change, an organization can sometimes find it difficult to alter the elements of its dominant logic. It may continue with beliefs and perceptions from its old dominant logic that are no longer accurate for the new environment. It may also, through the help of key decision-makers, develop a new dominant logic. The organization runs the risk that reliance on outdated old strategies or inaccurate new strategies can be ineffective and lead to failure.

Part of this inability to adapt is because management and board members have limits to what can be learned especially when the future is largely unknown due to drastic industry change (Simon 1991). Drastic industry change means decision-makers have no familiarity with the present situation, so reliable solutions from the past do not exist. It is then up to the organization and the key decision-makers to decipher the new information, without any prior exposure, and to formulate new strategies. There will always be the chance that the strategies chosen are ineffective because the organization is dealing with a large degree of unknowns.

*Proposition 1* is that the Pool's dominant logic prevented effective adaptation to industry change and significantly contributed to its financial failures. Senior management's effort to become a globally recognized agri-business cooperative was unsuccessful. Elements of the Pool's old dominant logic were still relied on as the industry changed. A revised dominant logic contained outmoded views and beliefs that were no longer appropriate for the new grain-handling environment. In addition, some of the new views – growth at all costs – were also not effective. The Pool's strategies in response to deregulation in the 1990s led to organizational failure because of the views and beliefs held by the Pool and some of its key decision-makers.

#### *2.4.2. Proposition 2*

The governance structure of an organization and the relationship between the board and management plays a major role in the decisions and strategies undertaken by the organization. Theoretically the board has power over management. The board provides strategic direction and management brings forward investment opportunities to achieve the strategic direction for the organization. It is the board's responsibility to

assess and give final approval on any investments. The board cannot fully monitor management nor does it have the same exposure to information as management. Information asymmetry creates opportunities for hidden action – i.e. a principal-agent problem is at work.

*Proposition 2* is that a principal-agent problem existed between Pool senior management and the board members. Information asymmetry and the inability of board members to fully monitor senior management allowed senior management to gain approval on investment proposals that should have been rejected by the board. Management failed to act in the interest of the organization. The board had grown to trust senior management, which increased the likelihood of a principal-agent problem.



## CHAPTER 3: THEORETICAL FRAMEWORK AND LITERATURE REVIEW

### 3.1. Introduction

This thesis draws from cognition and agency theory to explain how organizational failure can occur as a result of major industry change. Cognition theory explains how knowledge is created from information. Organizations rely on knowledge creation to make decisions and devise strategies. To remain successful organizations need to recognize and correctly interpret information relating to change. The source of an organization's knowledge is from its employees. Organizational knowledge is housed within its dominant logic. Major industry change can cause problems for organizations because the appropriate action is often outside the established frames of reference. Stated another way, if industry change is so drastic that an organization has no past experiences that parallel the current situation it may not know how to react. As new and critical information comes to an organization it may filter it out because without any resemblance to its past the information is deemed irrelevant (Bettis and Prahalad 1995). An organization may also ignore the information because it conflicts with established beliefs (Akerlof and Dickens 1982).

The relationship between a board of directors and management – such as in a co-operative – is subject to the principal-agent problem. The principal (board of directors) hires the agent (management) to undertake actions on the principal's behalf (Arrow 1985). The principal wishes for the agent to undertake actions that meet the interests of the principal. If interests do not align and the principal cannot fully monitor the agent and is less informed than the agent, the agent can behave opportunistically. The agent

may also “screen” or “hide” unfavourable information from the principal, which increases the information asymmetry (Monsen and Downs 1965).

This chapter starts with the concept of knowledge creation and how it is stored within knowledge structures. The formulation and content of knowledge structures and their limitations follow. Following this discussion is the importance of an employee’s knowledge structures on the decisions made in an organization. Individual knowledge structures are linked to an organization’s dominant logic. The elements of a dominant logic will be outlined. Why organizations find change difficult is looked at in terms of organizational blindness and a deeply rooted dominant logic.

An examination of agency theory comprises the second half of this chapter. Adverse selection and moral hazard are two outcomes of the principal-agent problem. The implications of moral hazard and information asymmetry on the board-management relationship are discussed. Information screening increases information asymmetry and promotes the principal-agent problem. Trust can escalate information asymmetry when the principal lacks business knowledge and skills, but trusts the agent.

The relationship between cognition and agency theory will conclude the chapter. It is the interaction of cognition and agency theory that forms the theoretical framework for this thesis.

### **3.2. Cognition Theory**

The distinction between information and knowledge is that information must first become knowledge before it is valued and used by individuals (Sanderson and Taylor 1999). It is knowledge, and not information, that an individual uses to make decisions. Information becomes knowledge as it is sorted and categorized into frames according to

“perceived similarities with other objects or events” from an individual’s background and past experiences (Fulton and Gibbings 2004, p. 167; Van De Ven 1986; Loasby 1976).

These frames comprise a knowledge structure or cognitive model. The knowledge structure includes rules and expectations about the world that are used to focus attention and make decisions (Fulton and Gibbings 2004, p. 168; Choo 2002). When an individual encounters a new experience with new information, he/she refers back to similar situations from his/her past and the knowledge gained from that past experience. The old knowledge will be used to interpret the new information and determine the appropriate action.

Knowledge is neither fully complete nor fully accurate. Individuals have different backgrounds and experiences; therefore no two individuals will have the same knowledge or insights (Loasby 2001). Put another way, different backgrounds and insights means individuals can interpret the same information differently and view the same environment differently. Individual mindsets and insights are subjective and the variation between individual insights means knowledge can never be known to be true or complete (Loasby 2002).

### *3.2.1. Bounded Rationality*

Knowledge is incomplete and inaccurate because there are limits to what an individual can know. There is too much information for a single individual to comprehend. An individual has rates and limits on the amount of information he/she can “receive, store, retrieve and process...without error” (Williamson 1973, p. 317). The information that we do intake is prone to error because the future and all of its probable outcomes is uncertain (Loasby 1976). Simon (1955) introduced the term “bounded

rationality” when referring to the limits on what an individual can know. Bounded rationality limits individuals from adapting optimally in complex environments because the full range of possibilities is unknown (Simon 1991). Limitations on the amount of information that an individual can process means each individual will select the information that best aligns with their past experiences or knowledge base and discard the excess information.

### 3.2.2. *Knowledge Structures*

Transforming information into knowledge is the process of learning. To learn, an individual draws from patterns, structures, and categories established from past experiences (Loasby 2001; Langlois 2001). An individual’s background, experiences and activities are sorted into “schemas” (Markus 1977) or “knowledge structures” (Walsh 1995). Throughout the cognition literature several terms – knowledge structures, frame of reference, cognitive framework, schema – are all used for the same concept. These terms all represent the structures created to organize an individual’s experiences for future reference in interpreting incoming information. Markus (1977) defined “schemas” as cognitive knowledge structures regarding specific concepts, entities and events used by individuals to encode and interpret incoming information efficiently. Walsh (1995) defined a “knowledge structure” as a mental template consisting of organized knowledge about an information environment that enables interpretation and action in that environment (p. 286).

Stated in another way, frames or slots within the mind hold similar knowledge. When sorting and categorizing information, the frames and slots are searched and like knowledge is inserted in the most similar frame. These frames or slots collectively

represent a knowledge structure. The knowledge structure controls the way an individual views the world. The knowledge structure plays a role in focusing an individual's attention; accepting information that fits existing memory patterns or that can easily have existing patterns extended to encompass it (Salgado *et al* 2002). If information conflicts with a knowledge structure, it can be deemed irrelevant and is disregarded (Witt 1998; Walsh 1995; Lord and Foti 1986).

Knowledge structures provide a template to map future experiences, control information processing, fill missing gaps in information, and facilitate problem solving, goal setting and goal execution (Taylor and Crocker 1981). They are the mechanism by which information becomes knowledge and helps individuals develop perceptions and interpretations of the environment in order to make decisions.

### *3.2.3. Knowledge of Decision Makers*

An organization must rely on its employees' knowledge structures and views of the environment in order to make decisions. The employees' knowledge becomes the organization's knowledge. The inaccuracies and incompleteness of the knowledge also become those of the organization. Having relevant background and experience among employees is therefore very important for an organization. What the decision-makers know and believe will influence the strategies an organization pursues.

There are key decision-makers in every organization. In a traditional hierarchical organization with top-down decision-making, the Chief Executive Officer (CEO) and senior management control the business decisions and hold the effective power in the organization. An organization must be mindful that its thought processes involve more than just the individual mind of the CEO (Fairbairn 2003c). If an organization's

governance structure includes a board of directors elected by its shareholders, it is the legal responsibility of board members to monitor the CEO and senior management. The knowledge and experience of board members and management is most influential in creating the organization's knowledge; it is important that they possess the backgrounds and insights necessary to ensure that the organization survives and adapts successfully to change.

#### *3.2.4. Organizational Knowledge Structures*

Like its employees, an organization must work within a framework or structure of assumptions and procedures if it is to function at all (Loasby 2002). Simon (1991) states an organization can only learn through what its current employees learn or by gaining new employees with new insights, ideas and knowledge. March (1991) supports Simon's view by stating that an organization stores knowledge in its procedures, norms, and rules and that knowledge is accumulated as its employees learn. March (1991) also states that learning is a two-way process; employees will gain from an organization's knowledge through instruction and training while an organization's knowledge grows from each employee's knowledge and beliefs (p. 74).

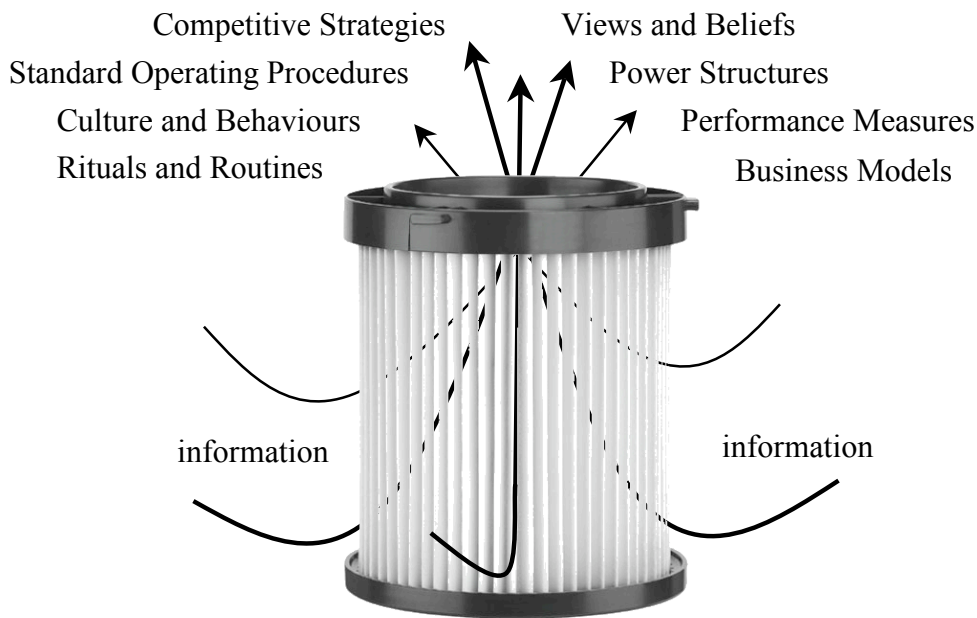
When an organization's employees come together and share their individual knowledge structures, a collective knowledge structure emerges (Walsh 1995, p. 295). This group-level knowledge structure has been referred to as organizational code (March 1991 p. 74), a dominant paradigm (Sanderson and Taylor 1999), or a dominant logic (Bettis and Prahalad 1986; 1995).

### 3.2.5. *Dominant Logic*

A dominant logic is an organizational knowledge structure built from its employees' knowledge structures (Bettis and Prahalad 1986; 1995). It serves as an information filter, directing attention on "relevant" information and discarding "irrelevant" data based on the contents of the knowledge structures. The filtration of relevant and irrelevant information is subjective. Organizations in the same industry undertake different strategies because organizations not only filter information differently but they also interpret information differently.

The dominant logic consists of an organization's beliefs, views, values, strategies, and culture, all of which impact the way an organization views the world (Bettis and Prahalad 1995; Sanderson and Taylor 1999). The dominant logic is an organization's "lens" for its environment. Prahalad (2004) further describes the dominant logic as the "DNA of the organization" with recipes for success, business models and standard operating procedures. As described by Johnson (1992), the information that "filters" into an organization helps to build competitive strategies, values and expectations, power structures, performance measures, reinforced behaviours and rituals and routines.

Figure 3.1 is a visual representation of a dominant logic and its various elements. The representation uses a filter to show that the dominant logic acts as an information filter. The arrows represent information available to the organization. New information passes through the filter and is "purified" as irrelevant information does not pass through the filter. The information that makes its way through the filter and out the top can be thought of as knowledge and can serve to guide decisions and influence behaviour.



**Figure 3.1. The dominant logic of an organization.**

Source: Author's own interpretation.

Bettis and Prahalad (1995) used the existence of a dominant logic to explain why organizations have difficulty changing even when they see change in the environment. A long period of success and stability reinforces the dominant logic and can result in deeply rooted views, expectations, and standard operating procedures. Tasks, decision-making and information processing become routine for an organization. The positive impact of this routine is that individuals thrive on regularity and will become efficient at repetitive tasks (Loasby 2001; Van De Ven 1986). This makes intuitive sense because knowledge structures are an individual's attempt to put structure and routine to the environment. In mastering routines, individuals and organizations learn what information can be ignored because it has less influence or is irrelevant (Salgado *et al* 2002). Routinization becomes a problem for the organization in periods of major change as the filtration process will



continue to filter out what it considers irrelevant information; the dominant logic may not adjust to industry changes making the organization susceptible to making inappropriate decisions.

The longer an organization operates in a stable environment the more standardized are its routines and procedures. This aids in the simplifying and speeding up the decision-making process (Bettis and Prahalad 1995, p. 11). An organization will tend to anticipate the future to be very similar to the current and past environment (Bettis and Prahalad 1995, p. 11; Amburgey *et al* 1993). This can be detrimental to an organization if there is major industry change, as the future will no longer represent the past. Standard operating procedures, beliefs and models that were previously successful are now outdated and may no longer be accurate. If a dominant logic is deeply engrained it may be too difficult to change (Bettis and Prahalad 1995).

Prahalad (2004) emphasized the need for market leading organizations to reassess traditional assumptions over time or the organization will be blind to new threats and opportunities (p. 172). The term “blind” refers to an organization ignoring information that has had less influence and an inability to see important developments outside its current range of vision (Walsh 1995; Salgado *et al* 2002; Loasby 2002). An organization can also be blinded by the strategies it adopts; if great effort is expended to adopt a new strategy the organization may fail to recognize information beyond the scope of the strategy. This is linked to cognitive dissonance – key decision-makers want to believe they have chosen the correct strategy and will intentionally blind themselves to information that suggests otherwise.

### 3.2.6. *Cognitive Dissonance*

Individuals can choose their beliefs and perceptions, and once chosen they persist over time (Akerlof and Dickens 1982). For example, it is human nature to believe that one's self is intelligent and makes correct decisions. A way to ensure one's beliefs are correct is to intentionally ignore or reject information that does not support their beliefs. An individual's ability to create persistent beliefs about the state of the world and ignore information that contradicts those beliefs is known as cognitive dissonance (Akerlof and Dickens 1982).

Akerlof and Dickens (1982) used the example of workers in unsafe job environments to portray cognitive dissonance. The workers prefer to believe their job is safe because only unwise individuals hold jobs that are dangerous (p. 308). The problem with creating a belief that the job is safe, when it is not, is that the worker may make "costly judgment errors" such as not wearing safety equipment (p. 308; 310).

Cognitive dissonance also applies to an organizational setting. Key decision-makers will believe they are intelligent and can successfully lead the organization. Information that indicates a past decision was poorly timed or was the incorrect will be overlooked because it conflicts with this belief. This helps explain why some organizations, despite evidence of net losses and declining market share, continue with the same business strategies. Akerlof and Dickens (1982) claim that as the magnitude and difficulty of a decision increases, so does the belief that the decision is good for the organization (p. 310).

Knowledge structures with inaccurate perceptions can persist because cognitive dissonance may cause key decision-makers to purposely ignore information that indicates

the perceptions are incorrect (Akerlof and Dickens 1982). Cognitive dissonance therefore helps to maintain elements of a dominant logic.

### 3.2.7. *Adapting to Change*

If industry change is incremental, an organization is often able to slightly adjust its dominant logic because the information filter will accept information that is similar to past information (Salgado *et al* 2002). To adapt to industry change, new strategies and decisions are required. When industry change is drastic, however, information is no longer familiar and the organization has difficulty discerning between important and unimportant information (Salgado *et al* 2002, p. 176). The dominant logic may not be able to deem any information as relevant therefore preventing adaptation to the new environment. A continued reliance on the old dominant logic can lead to failure for the organization.

If an organization is able to recognize the need for change it will create a new dominant logic. In this process there will be a tendency to use elements from the old logic, particularly where they support key elements of the new logic. Key decision-makers will have a significant influence on the formation of new views and expectations. An organization can bring in new people to key decision-making positions in order to gain different knowledge and experiences for incorporation into a new dominant logic.

Organizations may also have to contend with the relationship between management and board members. The board relies on management to handle the daily activities of the organization. Management can take advantage of this reliance and pursue its own interests if the board has less information and an inability to fully monitor all of management's actions. This is known as the principal-agent problem.

### **3.3. Agency Theory**

An agency relationship is when a principal hires an agent to carry out a task on the principal's behalf (Arrow 1985). A classic example of the agency relationship is when the shareholders (principal) of an organization hires management (agent) to carry out the day-to-day activities of the organization to achieve the interests of the principal. If the interests of the principal and agent do not align, the "relationship" can become a principal-agent problem. If the agent's actions cannot be observed by the principal without a cost and if the agent has more information than the principal then it is possible for the agent to pursue their own interests rather than the interests of the principal (Tirole 1989; Milgrom and Roberts 1992). Thus, the two important assumptions for a principal-agent problem are information asymmetry and costliness to obtain information.

In businesses, and particularly co-operatives, the principal-agent problem typically arises in two situations. The first is the relationships between the members and the elected board of directors, with the members as the principal and the board as the agent. The second is the relationship between the board of directors and senior management, with the board as principal and senior management as the agent. Most of the focus of this thesis will be on the second of these two situations.

Central to the principal-agent problem is information asymmetry. There can be information asymmetry between board members (principal) and management (agent) because board members do not possess the same business knowledge as management and they do not have the same information available to them. Managers have daily contact with the business side of the organization, whereas board member contact with the organization is at board meetings. Management is also more informed because they are

hired for their expertise (Lipsey *et al* 1997). In large complex organizations, board members must rely on management for an information synopsis. When the agent has a deeper knowledge than the principal there is information impactedness; the agent can distort any information they disclose because it is costly for the principal to reach information parity (Arrow 1969).

### 3.3.1. *Adverse Selection*

The principal-agent problem involves two distinct behaviours – moral hazard and adverse selection (Arrow 1985; Tirole 1989; Milgrom and Roberts 1992). Adverse selection is the *ex ante* hiding of information. This concept can be explained with an example from life insurance. Individuals tend to know if they are at higher risk for dying prematurely because of unhealthy habits (i.e. smoking) or family history of disease (i.e. cancer). These individuals will not wish to disclose this information to a life insurance company because the insurance company will refuse to provide insurance or will charge high premiums (Arrow 1985). Adverse selection is the result of “precontractual opportunism” where one party has private information before entering into a contract (Milgrom and Roberts 1992). For the purposes of this thesis, moral hazard more aptly fits the Pool’s situation than adverse selection; the focus will now turn to moral hazard.

### 3.3.2. *Moral Hazard*

When an agent’s efforts are not directly observable by the principal and the agent has limited liability there is incentive for the agent to shirk on the effort that is exerted towards meeting the principal’s goals; this is known as moral hazard (Arrow 1985, p. 39; Eisenhardt 1989). A common example is vehicle insurance. An insured driver can be less

cautious because their driving habits are not directly observable by the insurer and a small deductible will cover any losses incurred in the event of an accident. Hidden action is the non-insurance term for moral hazard (Arrow 1985).

An agent may be intentionally careless because his/her interests do not align with the principal and the agent is not fully liable for the consequences of his/her actions (Milgrom and Roberts 1992, p. 168). It is human nature for an individual to pursue their self-interest (Monsen and Downs 1965). The interests of the principal are to ensure profitability of the organization, increase share value and maximize the long-run value of the organization (Milgrom and Roberts 1992, p. 181). The interests of the agent may include pursuing their own “goals of status, high salaries, expensive perks, and job security” (Milgrom and Roberts 1992, p. 168). Differing interests can cause the agent with critical information to intentionally report information that is either incomplete or inaccurate which can limit the principal’s ability to make appropriate decisions (Milgrom and Roberts 1992).

### *3.3.3. Information Screening*

Intentionally withholding information is also known as information “screening”. Screening is a necessary function of organizational size, but it leads to inefficiencies when there is a difference in motives (Monsen and Downs 1965, p. 231). Monsen and Downs (1965) proposed that large hierarchical organizations that have ownership and management functions carried out by two separate groups – the board of directors and management – risk a situation where management acts in their own self-interest rather than in the interest of shareholders. The shareholders’ goal is to generate a steady income from dividends and appreciation of the stock price. The management’s goal is to

maximize lifetime income through salary increases, stock options, performance bonuses and promotion (p. 225).

To prevent the discovery that management's actions do not fully reflect shareholder interests, management can screen information. Board members "typically know far less about the firm's situation than managers" because they remain "remote from the firm's actual decision-making" (Monsen and Downs 1965, p. 225). Board members rely on reports from management to learn about the organization. The only way to know if profit and stock growth has been maximized is to compare performance with similar organizations. As long as management ensures the board's targeted stock price increase and dividend payout are achieved, the board will not suspect that management's efforts are in pursuit of self-interests (p. 226).

Screening may occur within each level of an organization. To achieve goals of wage increase and promotion, employees must gain approval from their superiors; likewise, senior-level managers will need to gain approval from the board of directors. Achieving a stock price increase and paying out dividends is part of the approval process. "Screening" information so that only favourable data is passed on to superiors is the other part to gaining approval. Not sharing unfavourable information with superiors can lead key decision-makers to make ineffective or improper decisions because they have not been made aware of all the pertinent issues.

Employees may begin to keep their concerns hidden and screen information rather than jeopardize their employment. Bartunek and Ringuest (1989) found that employees who held different beliefs from their superiors received less recognition for their efforts and were more likely to leave the organization than employees who did not raise dissent.

It is management's responsibility to "motivate subordinates" and initiate change in the organization (Mintzberg 1971, p. 105). As a result, management may feel it is in their best interest to release employees who disagree with the direction of the organization.

#### 3.3.4. *Trust*

Trust is "the willingness of a party to be vulnerable to the actions of another party based on the expectation that the party will perform a particular action important to the trustor, irrespective of the ability to monitor or control the other party" (Mayer *et al* 1995, p. 712). Sabel (1993) defined trust as the "mutual confidence that no party to an exchange will exploit another's vulnerabilities" such as adverse selection and moral hazard. When there is trust, the principal is confident the agent will do what is best for the organization and its membership.

A principal's belief that an agent is trustworthy can exacerbate the principal-agent problem. In order for a large, hierarchical organization to function efficiently there is delegation of responsibility. Trust is placed in the individuals given responsibility because full supervision is impractical (Mayer *et al* 1995). Trust is common in exchange relationships (Barney and Hansen 1994) even though it is difficult to distinguish between true and false claims of trustworthiness (Williamson 1985). The agent can exploit that trust because the principal is unable to fully monitor the agent.

Trust is based on perceived characteristics of loyalty, competence, consistency, reliability, and integrity (Mayer *et al* 1995). Trust can emerge if the principal is "susceptible to the advice, information and apparent experience" of the agent (Loasby 2002). If an employee's performance of a task is satisfactory, a manager's perception of the employee's trustworthiness increases (Mayer *et al* 1995). Likewise, if an agent has



been performing well for a period of time, the principal has reason to trust that satisfactory performance will continue. An employee with a proven track record will be given increased responsibility (through promotion) with the expectation that success for the organization will continue. Influential or charismatic organization leaders can build trust into an organization's culture and the trust can be sustained long after the leader has left the organization (Barney and Hansen 1994).

### **3.4. Co-ops and principal-agent relationships**

When applying the principal-agent to an agricultural co-operative, it is useful to think of a chain of principal-agent relationships within the organization. In the first part of the chain, the farmer-member is the principal and the elected board members are the agent. The board, in turn, is the principal and senior management is the agent in a second part of the chain. Breton (1995) applies principal-agent theory to superior-subordinate relationships in hierarchical organizations; each level within an organizational structure can be viewed as a principal-agent relationship. The concept of layers of principal-agent problems is found in Monsen and Downs (1965) explanation of information screening that occurs between the levels of a hierarchical organization.

In a co-op the farmer-members are the ultimate principal with the elected board members serving as the agent. For the purposes of this research the focus will be on the principal-agent relationship between the elected board members and the management; in this relationship the board members (principal) hire management (agent) to handle the day-to-day activities of the co-op. This focus on the board-management relationship is chosen because it is commonly the focus of work done on organizations that are not co-

operatives and because it is believed that it is at this level that issues of dominant logic arise.

The member-board relationship is, however, critical to a co-op's success. A co-op is a nonprofit business voluntarily owned and controlled by members as well as operated by and for the members (Fulton 2003). A co-op is different from investor-owned firms because it has "members that regularly use and purchase the good or service provided by the organization that they themselves created"(Fulton 2003, p. 3). Individuals will become members of a co-op because the co-op is seen to achieve the individual's wants and needs. Member loyalty or linkage is derived from a trust and a perception that the co-op is an efficient agent of its members (Fairbairn 2003c, p. 7). Members will need to feel informed about the co-op's business and financial performance to retain loyalty to the co-op; this is what (Fairbairn 2003c) refers to as transparency (p. 12). Without linkage and transparency members will not feel their interests are being served and may decrease their patronage. Members receive information about the co-op from the elected board members and delegates. If the board-management relationship suffers from the principal-agent problem, the member-board relationship will likely also be affected.

Satisfying co-op members is more difficult than satisfying shareholders of an investor-owned firm. Cook (1994) states that the role of the CEO in a co-op is more difficult than that of a CEO in a for-profit firm. Since co-op members are both the owners and users of the co-op they want to see the organization profit and they want favourable prices for the good and services sold or received. Co-op managers need to maximize profit and producer surplus. In addition, co-op members are not homogenous; Richards, Klein and Walburger (1998) found that agricultural co-op members value co-op

goals differently. For example, young farmers (under 35 years of age) care more about business performance than social aspects of co-ops (Richards, Klein and Walburger 1998, p. 27). The reality is that a co-op manager's compensation is based on the co-op's financial performance. Therefore, managers are "not likely interested in making decisions that would indirectly benefit members, since such actions are almost invariably less profitable for the co-op" (Fulton 1989, p. 15). Co-op managers can be expected to withhold information on what they would consider "poor" business, which erodes the board members' power and leads to information asymmetry and the principal-agent problem.

The divergence of interests between a principal and agent has also been referred to as the control problem in agricultural co-operatives (Cook 1995). The principal lacks control over the agent because it cannot fully monitor and evaluate efforts. Staatz (1987) noted that cooperatives will reach a point in size and complexity that makes it impossible to fully monitor managerial behaviour, regardless of the board members' talents (p. 50). The problem can increase in agriculture co-operatives because they lack a publicly traded share that would serve as an indicator of financial health (Cook 1995). Featherstone and Al-Kheraiji (1995), along with Hailu (2005), present a test of the agency problem in co-operatives.

### **3.5. Summary and Conclusions**

Cognition and agency theory come together to provide a theoretical framework as to why a co-operative can fail under industry change. In a co-operative, the board of directors and management are the key decision-makers. The knowledge and experience of current and previous board members and management is embodied in the co-op's

cognitive processes or dominant logic. New management and board members bring new experiences and knowledge to the co-op. The cognitive processes of key decision-makers are used when interpreting information and devising strategies for the organization.

Drastic industry change can mean a co-op's established standard operating procedures, beliefs and strategies are no longer accurate. If the new environment is foreign to the co-op and its decision-makers, knowing how to react can be onerous or completely overlooked because the co-op is blind to the impending change. The dominant logic needs to be rebuilt. The co-op will need to rely on its key decision-makers to help build a new dominant logic. The personalities of key decision-makers can affect the rebuilding process; for example, hubris can hamper the co-op's change capacity.

The principal-agent problem brings an added dimension to the difficulty in changing the dominant logic and reacting to change. Management can behave opportunistically to achieve their own interests because board members are unable to fully monitor management and typically do not possess the same information as management.

The board has to trust that management will carry out the direction and strategies of the co-op. Over time trust can build between the board and management. If board members trust management they trust management's beliefs and views and hold them as their own, in this way inaccurate beliefs can spread among decision-makers. Inaccuracies in beliefs and knowledge leads to a flawed dominant logic and errors in the cognitive processes which can lead to ineffective decision-making.

Senior management brings forth investment proposals based on the direction set by the board members. The board members are the final check and balance for a co-operative and they need to conduct adequate analysis to ensure the correct decision is being made. However, the board cannot ascertain if management has exercised complete due diligence on investment proposals. There may also be opportunity for management to undertake activities without the board's full knowledge.

Co-op board members need to possess some financial and analytical skills so they can conduct adequate analysis of the investment assumptions and projections.

Agricultural co-operatives with farmer-elected board members, who are farmers themselves, may not have the knowledge and business skills that senior managers possess (Ernst and Young 2002, p. 30). If board members substitute trust for business acumen, they will believe that management provides accurate projections and assumptions. One result of such behaviour is approval being granted to investments that are not feasible.

The theory around cognitive processes, dominant logic and cognitive dissonance were built into *Proposition 1* outlined in Chapter 2. Principal-agent theory and the role of trust were embodied in *Proposition 2*. To assess these proposals a case study approach was used – the elements of the case study are discussed in the following chapter. After a thorough discussion of the grain industry deregulation in Chapter 5 and a historical recount of the Pool's decision-making from 1970 until 2000 in Chapter 6, the interview responses and their connection to the theory presented in this chapter are shared in Chapter 7.

## CHAPTER 4: METHODOLOGY

### 4.1. Introduction

A case study research strategy was used to test the two propositions of this thesis (refer to page 17). Key principles for successful case study research – multiple evidence sources, an evidence database, and a chain of evidence – and their implementation in the thesis research will be discussed. A description of the data sources, data collection and analysis, and interviewee selection processes are included in this chapter. Twenty-one personal interviews served as a major data source for this thesis. A discussion of the interview design, timeline and participation rate conclude the chapter.

### 4.2. Case Study Research

When answering “why” and “how” research questions, such as why did the Pool fail financially, case studies are a preferred research strategy (Yin 1994). A case study approach using survey data, interviews and published documents were used to research the agricultural co-op failures discussed in Chapter 2. Case studies can analyze a single situation or case and the findings can be used to draw conclusions on similar scenarios. Determining why the Pool failed financially can assist in devising plans and strategies for co-ops facing parallel situations.

There are six major sources of data for case studies. A high quality case study should include multiple sources of evidence (Yin 1994). Documentation and archives are important for most case studies and include newspaper articles, memoranda, meeting minutes, personnel records, annual reports, and previous studies or surveys on the event in question (Yin 1994, p. 80). Participant and direct observation are often used when the

topic of interest is ongoing and not an historical event (p. 86-87). Physical artifacts tend to be collected during the observation period. Interviews are one of the most important sources of case study information (Yin 1994, p. 84).

Open-ended interviews are a common approach because they ask both specific fact-based questions as well as questions aimed at gaining the interviewees opinion about an event. Interviewees can serve as informants providing insight on the topic of interest that is possible only because of their direct involvement with the event in question. Yin (1994) suggests audio recording interviews to ensure an accurate rendition of the responses. Timely transcription, coding and analysis are necessary in order to avoid forgetting, oversimplifying or losing interest in the interview responses (Miles 1979). The same individual collecting the data should also code and analyze the data (Glaser 1978). It is important to use a formal database to reduce the volume and to code the data into themes, which can be easily retrieved at a later date (Yin 1994).

When presenting case study evidence, sufficient citation of the data sources is required to gain the reader's confidence that the subject has been thoroughly researched. Interview data should corroborate others sources of data; creating a chain of evidence using multiple sources of evidence increases the acceptance of a case study (Yin 1994, p. 92-94). When using interviews as a data source an effort has to be made to avoid becoming dependent on one interviewee's responses; aggregating the responses into categories identifies views and opinions that are shared among interviewees thereby increasing the validity of the interview responses. In the same respect, data that supports and challenges the propositions should be presented in the case study to show that the investigator is not biased and selective in the evidence (Yin 1994, p. 149).

### **4.3. Case Study Application**

Case study evidence was sourced from SWP annual reports, SWP press releases, published books on the Pool, newspaper and magazine articles, a Master's thesis on the Pool's share conversion, and personal interviews. These multiples sources of evidence provided supporting evidence to the interview responses and are included in the written case study in Chapter 7.

Data collection through personal interviews proved to be a key source of case study evidence. Interviewees were either past directors or management employees of the Pool or were past grain industry participants. Each interview followed a semi-structured list of questions. Interviewees were asked the same set of questions and were welcome to comment outside these specific questions. The interview responses provided insight into the events leading up to the Pool's financial troubles and corroborated with evidence from other sources.

To analyze the interviews, responses were coded and aggregated into main themes related to the two propositions, which is the process recommended by Stake (1995) and Yin (1994). To ensure consistency in the coding, the graduate student (Kathy Lang) administered the interviews, transcribed the audio recordings and coded the responses. Two coding databases were generated - a Microsoft Word document and a Microsoft Excel spreadsheet - for easy retrieval and review of interview responses.<sup>1</sup> Coding themes included industry change, decision-making, trust, beliefs, investments, analysis, and power. The word-processed document was replaced with a coding spreadsheet that simplified searching and sorting for applicable quotes. The spreadsheet contains 330 individual quotes that were used to write the case study analysis.

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<sup>1</sup> Coding software is available (e.g. NVIVO) but it was not utilized in this research.



All interview responses in the written case study have a footnote indicating a corresponding numbered transcript from which the response came. Each interviewee was given two random transcript numbers to ensure anonymity. The footnoting was done to show that multiple interviewees made the same point and that no one interviewee was overly referenced.

#### **4.4. SWP Interviews**

Every effort was made to conduct the interviews in-person; only one of the twenty-one interviews was conducted over the telephone. Participants were deliberately selected on the basis of their past affiliation with the Saskatchewan Wheat Pool or the grain handling industry. Due to the specific nature of the interview selection, potential participants were approached individually in order to limit any feelings of coercion to participate or not participate.

Interviewees included former SWP senior executives, managers, employees, elected board members and grain industry participants. Several years have passed since the events of major interest to the research occurred. This passage of time and the major personnel changes that have occurred at the Saskatchewan Wheat Pool meant that the former executives and board members this study was interested in were no longer with the organization. As a result, it was felt that the interviewees would be in a position to comment on the historical decisions made by the Saskatchewan Wheat Pool.

The aim of the interviews was to have participants outline how they perceived decisions made by the Saskatchewan Wheat Pool and why they believed the decisions were made in the fashion that they were made. Interviewees were asked about the model or culture that they believed was at work in the co-operative, as well as how this model or

culture influenced the questions that were asked internally, the data that was collected, the conclusions that were reached and the actions that were taken. The questions posed to the interviewees were intended to guide the participants and to garner their thoughts on the decision-making processes of SWP. Participants were encouraged to let their responses go outside the expected scope of the interview if they felt their stories were important to the events.

Prior to conducting the personal interviews approval from the University of Saskatchewan's Behavioural Ethics Committee was required. Approval of the study's procedures for data collection, storage, and use as well as guidelines for respecting interviewee's anonymity was granted on July 15, 2004.

#### *4.4.1. Interview process*

Initially potential interviewees were contacted by phone and only saw the interview questions at the time of the interview. By the seventh interview, potential interviewees were emailed or faxed the questions and the Interview Consent Form prior to making a decision on whether or not to participate in an interview. The script and questions used for each semi-structured interview can be found in Appendix A. Allowing potential interviewees to see the questions before committing to an interview enabled them to make an informed decision on whether or not to participate based on the questions that were being asked and their ability to answer them. It also gave the interviewees a chance to compose their thoughts and prepare answers to the questions prior to the interview. The consent form was included so each potential interviewee knew how the interview would proceed as well as how the interview responses were going to be used. The Interview Consent Form is found in Appendix B.

Each interview took between 60 and 90 minutes to conduct. Each interview was audio recorded and then transcribed. Transcribing an interview generally took between five and six hours. Voice recognition software could not be used; even though the technology has improved immensely, most products are still only able to recognize one person's voice. Once an interview was transcribed, the transcription was forwarded by mail or e-mail to the interviewee for review and editing. The interviewee could drop out of the study without penalty at any time during the actual interview or after the transcription was sent for review. Interviewees returned their edited transcripts along with a signed Interview Transcript Release Form to complete the interview process. Interviewee edits were incorporated into the electronic copy of the transcript.

The Interview Transcript Release Form (Appendix C) gave each interviewee the opportunity to indicate the level of anonymity they wanted to retain – 95% of the interviewees chose to remain anonymous with none of their remarks attributed to them by name. In writing the case study, interview responses could be attributed to an unnamed individual such as a manager or board member or to a composite profile, which is the same approach used by Fairbairn (2003a). Whenever possible responses were aggregated and stated as “several interviewees commented that” or “several board members felt”. Keeping identities and remarks anonymous puts interview participants at ease knowing that their identity is kept in confidence and it resulted in the interviewees being more willing to share thoughts and views.

#### *4.4.2. Selection of potential interviewees*

The list of interviewees was not randomly selected. A list of board members and management was compiled by reviewing the 1980-2003 SWP Annual Reports. This

process generated a list of ninety-seven potential interviewees. Consultation with Dr. Murray Fulton (thesis advisor) narrowed the list to approximately twenty-five potential interviewees; selection was based on importance of position – e.g. Board President, Board Vice-President, CEO – and Dr. Fulton’s personal perception regarding the willingness of certain individuals to participate. Hand selecting the individuals to participate in an interview poses a risk of selection bias because the individuals could be purposely selected based on their perceived ability to offer insights that support the research propositions.

To reduce the selection bias the other thesis committee members, Dr. Richard Gray and Ken Rosaasen, were invited to suggest additional people to interview. This meeting occurred on December 22, 2004. On January 10, 2005, committee members were provided with a list of thirty-five individuals who would be or had already been approached for an interview – the names of who accepted or declined an interview were not disclosed to the committee. The purpose of sharing this list was to ensure that the potential interviewees represented a balanced cross-section of management and board members. This was a one time occurrence as the committee did not review the list a second time; committee members were satisfied that a sufficient range of management and elected members would be approached. Taking into account committee member and interviewee suggestions, the final list of potential contacts was thirty-nine individuals. Only the thesis advisor and the graduate student (Kathy Lang) know which individuals from the list of thirty-nine potential interviewees accepted a request for an interview.

#### *4.4.3. Participation Rate*

Twenty-two personal interviews were conducted with past Pool senior executives, management, elected members and grain industry participants. Thesis Advisor Dr. Murray Fulton participated in thirteen of the interviews. There was a 78 percent acceptance rate of interview requests. Twenty-eight individuals from the list of thirty-nine potential interviewees were approached for an interview; three immediately declined, three initially accepted then declined prior to their interview, and twenty-two accepted and completed interviews. Responses from twenty-one of the interviews are presented and analyzed in this thesis; one of the interviewees did not complete the Transcript Release Form making his/her interview responses ineligible for use in the thesis.

Eleven individuals on the potential interviewee list were not contacted for various reasons; two would not return phone messages requesting an interview, active phone numbers could not be found for two others, and the remaining seven were not contacted due to timing reasons.

Interviews began September 22, 2004 and the final interview was conducted April 30, 2005. The completion date for the interviews was four months longer than the projected timeframe outlined in the ethics application. Scheduling conflicts were part of the reason for the interviews taking longer than anticipated to complete. The interview period was also prolonged because additional interviews were not scheduled until transcribing was current.

## CHAPTER 5: WESTERN CANADIAN GRAIN HANDLING INDUSTRY

### 5.1. Introduction

Several key regulations and governing bodies were put in place by the federal government early in the 20<sup>th</sup> century that helped develop the grain economy. The federal government shaped the prairies through the provision of the National Policy to settle the west and build a railway connecting eastern and western Canada. The Dominion Lands Act of 1872 offered a quarter-section of land for ten dollars provided settlers built a home and broke the land (Fowke 1957). The Crow's Nest Pass Agreement (1897) paid Canadian Pacific Railway (CPR) \$3.4 million in land, mineral rights and cash to complete a railway to the mineral-rich Kootenay area of British Columbia. In exchange for the government assistance, CPR agreed to move grain at fixed freight rates in perpetuity (Fulton *et al* 1989, Fowke 1957). The *Canada Grain Act* (1912) combined earlier acts – the 1900 *Manitoba Grain Act* and the 1904 *Federal Grain Inspection Act* – to oversee grain inspections, grading and loading platform construction (Fowke 1957).

Strong producer lobbying over the years has seen the government take ownership in infrastructure, provide capital assistance, introduce regulations, and assume control of grain marketing. By the 1970s the government began to try to deregulate and move to a more commercially-oriented grain transportation system. Lobbying efforts by the Prairie pools and farm lobby groups held off statutory freight rate removal from the 1980s until 1995. However, globalization and free-trade agreements pressured countries to reduce government subsidies and support. In the 1990s the WGTA was repealed, railways

moved rapidly to further abandon branch lines while elevators hurried to relocate to the main lines.

The history of prairie agriculture is full of change. In order to gain an appreciation for the amount of change being faced by the Pool and the other grain handling companies this chapter summarizes some of the major events throughout the 20<sup>th</sup> century. The aim of this chapter is to show that the change required all grain companies, including the Saskatchewan Wheat Pool, to adjust their strategies for the new environment.

## **5.2. The Crow Rate**

On September 6, 1897 the Canadian Pacific Railway Company (CPR) and the federal government signed an agreement for the construction of a railway from Lethbridge, Alberta through Crow's Nest Pass to the mineral-rich area near Nelson, British Columbia (Fowke 1973, p. 54; Library and Archives Canada website). Compensation for building the railway included a \$3.4 million cash subsidy and 3.75 million acres of land containing lumber and minerals (Hall 1977, p. 36). In return, CPR agreed to rate reductions on eleven commodities. Of most relevance to the grain industry was the reduction of eastbound rates for grain and flour by three cents per hundredweight with the new agreed upon rate holding in perpetuity (Crow's Nest Pass Agreement). The rate effective September 1, 1899 from Regina was 20 cents per hundredweight (Hall 1977, p. 36). For a time - October 7, 1903 until May 31, 1918 - the CP charged rates below the effective rates because CN Rail had reduced its rates and CP Rail had to follow suit in order to remain competitive (Hall 1977, p. 36). From 1918 until 1924, the *War Measures Act* suspended the Crow rate (Hall 1977, p. 37). In 1925, the rates were made

statutory at 20 cents per hundredweight under the *Railway Act* and were applied to any existing and future points on any railway west of Thunder Bay for grain and flour moving east to export position (Hall 1977, p. 38).<sup>2</sup> Grain and flour moving to the Pacific coast was added in 1927 and the Port of Churchill was added in 1931 (Hall 1977, p. 38). The Crow Rate, as it is commonly referred to, accelerated and expanded the wheat economy and encouraged the production of bulk grains.

### **5.3. Farmer Lobbying**

Producers proved early on that they could band together to exert effective pressure on the government to have their needs met. Early in the 1900s farmers became involved in grain handling. Fowke (1957) describes how “agrarian protest” made demands for increased government control and resulted in legislation such as the *Canada Grain Act*. Producers felt the grain trade was dominated by a monopolistic or oligopolistic structure. The line elevator companies were believed to collude on prices, weights, grades and dockage (Fowke 1957, p. 117). The 1904 *Federal Grain Inspection Act* was put in place to resolve these issues, but producers felt active involvement in the grain handling industry was also needed.

One of the first steps farmers took was to create the Grain Grower’s Grain Co. in 1906 to protect grain at terminal position. Next farmers raised capital and built their own elevators. By 1910 there were sixty farmer-owned elevators – 26 in Manitoba, 29 in Saskatchewan, and 5 in Alberta (Fowke 1957, p. 127). All the elevators were owned separately. The municipal and farmer-owned elevators did bring some necessary competition, but patronage was lacking. Shareholders and directors could be found

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<sup>2</sup> The statute put an end to CP Rail’s literal interpretation of the Crow’s Nest Pass Agreement; CP was only honouring the Crow rate on lines that existed when the Agreement was initially signed in 1897 (Hall 1977, p. 38).



hauling to line companies (p. 131). It seemed “farmers went where they believed they were getting the best terms” (p. 135).

The Saskatchewan Co-operative Elevator Company and United Grain Growers (formed through the 1917 amalgamation of Alberta Farmer’s Co-operative Elevator Company and Grain Grower’s Grain Company) received advances from their respective provincial governments to cover 85 percent of the cost to construct or purchase elevators that would be owned and managed by farmers (Fowke 1957, p. 147-148). These elevators helped to make special binning and fair grading normal practice. By 1920, these farmer-owned elevators had representation at 50 percent of the Prairie shipping points (650 elevators) and controlled one-third of the terminal capacity.

Farmers constantly pressured the provincial and federal government to take control of the market and have ownership in the elevator system. The government was not interested in public ownership. Persistence paid off, however, as farmer lobbying led to the 1913 federal government construction of inland terminals in Moose Jaw, Calgary, Saskatoon, and Edmonton along with a terminal at Port Arthur in eastern Canada (Fowke 1957, p. 162). Farmers were not the only ones asking for government support and involvement. During WWI, demands for milling exceeded the available supply and the prices rose from \$1.90 per bushel to \$3.00 per bushel on the Winnipeg Grain Exchange (WGE). The Winnipeg Grain Exchange asked the federal government to step in; wheat futures stopped trading from September 1917 until July 21, 1919 (Fowke 1957, p. 170). To control movement of grain, the Board of Grain Supervisors was put in place to sell grain at fixed prices. Once the war ended in November 1918 the government wanted to quickly withdraw from the grain business and let the open market resume. But

speculative movements within the first ten days of futures trading forced the government to establish the Canadian Wheat Board. The CWB had a one-year monopoly on foreign and domestic sales of wheat and flour. Wheat futures trading on the WGE resumed August 18, 1920. By the fall the CWB's monopoly power was removed despite producers' interests in making it permanent. Together the Western Grain Growers, the Canadian Council of Agriculture and western legislatures made repeated presentations calling for the reinstatement of the CWB (Fowke 1957, p. 262-263).

Farmers protested the Exchange, arguing speculation led to depressed prices that “injuriously affects the farmer and the community” because the price of grain is depressed in the fall when farmers are selling the bulk of their crop (Fowke 1957, p. 189). In all actuality the price slump experienced each fall may have had more to do with farmers “dumping” between 70 and 75 percent of their wheat production on the market during the three-month harvest period in order to generate much needed cash flow; the over-supply would have suppressed prices. Wheat growers wanted to see the Winnipeg Grain Exchange and the open market replaced by a government agency that would control prices. Three federal royal commissions were initiated to review farmer complaints. The commissions found that speculation was an integral part to the proper functioning of the futures markets (Fowke 1957, p. 188-190). The *Royal Grain Inquiry Commission* (1925) found that at times speculators magnified price fluctuations causing society to suffer, but overall speculative activity tended to stabilize and reduce fluctuations (p. 189). The *Stamp Commission* (1931) agreed with the findings of the 1923-1925 Commission describing the futures market as a “distinct benefit to the producer in the price which he receives” (p. 193).

#### **5.4. Advent of the Prairie Pools**

Producers decided to establish provincial wheat pool elevators to have a producer-owned and producer-controlled alternative to the open market. They would have rather had a “governmental monopoly agency which would provide not an alternative to, but an exclusive replacement for, the open market system” (Fowke 1957, p. 198). The aim of pooling was to narrow the spread between the local selling price for Canadian wheat and overseas prices (p. 207). Establishing a marketing agency that would pool grain and sell the stocks evenly over the crop year was anticipated to lead to a higher average price (p. 209).

In August 1923, American co-op advocate – Aaron Sapiro – gave pooling co-op sales pitches to farm leaders across the Prairies stressing the need for “orderly marketing” (Fairbairn 1984; Fowke 1957). Through a pool, grain would be marketed throughout the crop year and the revenues pooled so all farmers would receive the same price for each grade of grain regardless of when they delivered (Fowke 1957, p. 197). Producers would receive an initial payment at time of delivery followed by adjustment, interim and final payments as the crop year progressed and expected prices for grain became more certain. The concept of pooling was already being used by egg producers in Prince Edward Island, fruit growers in British Columbia, cheese factories in Ontario, and by marketing organizations all over the United States (p. 198). The co-op movement was also well established in the United States with 1,800 co-ops being formed in 1920 alone (Fowke 1957, p. 213).

Five-year contracts representing 50 percent of a province’s seeded acreage were a stipulation before a pool could commence operations. Pooling campaigns began for each

of the three Prairie Provinces. The Alberta Wheat Pool reached the required contracted acreage target before Manitoba and Saskatchewan; it began operations in 1923.

Saskatchewan Wheat Pool had to hold two pooling drives before the 50 percent acreage target was attained. Both SWP and Manitoba Pool Elevators were ready to market farmers' grain in the 1924-25 crop year.

#### *5.4.1. Central Selling Agency*

In its early years, the SWP was integrated functionally with the Alberta and Manitoba pools. The Prairie Pools jointly owned and controlled the Central Selling Agency (CSA), which marketed grain on farmers' behalf from 1924 until 1931. The CSA had offices throughout Canada and the world; 28 offices in 15 importing countries (Fowke 1957, p. 221). The CSA was into its second round of five-year delivery contracts when a series of global events caused the federal government to take control of CSA operations in 1930.

Troubles began to emerge when in 1928 Canada produced a large, poor quality wheat crop that only increased the already large surplus world wheat stocks. There was a 48.4 million bushel carryover into the 1929-30 crop year. The CSA set the initial payment at \$1.00 per bushel. Speculative flurry led to the New York stock market crash on October 29, 1929 now known as "Black Tuesday" (Fowke 1957). By the end of the crop year prices were below \$1.00 per bushel. This meant the CSA had overpaid its 140,000 members a total of \$22 million (Fowke 1957, p. 251). These debts accrued to the Pools and took the next 20 years to pay off (see Table 5.1).

**Table 5.1. Debt from the Central Selling Agency's 1929-30 overpayment.**

Province	\$ millions of overpayment	Date paid off
Manitoba	\$3,364,722	October 1949
Saskatchewan	\$13,265,054	September 1949
Alberta	\$5,520,162	June 1, 1947
TOTAL	\$22,149,938	

Source: Fowke 1957.

For the 1930-31 crop year the pools had their provincial governments secure the bank advances against any losses. The initial payment started at \$0.70 per bushel, but was reassessed and dropped to \$0.50 per bushel by November 11, 1930 as futures prices continued to decline (Fowke 1957, p. 248). The banks became reluctant to advance funds to meet CSA's margin calls. By the end of November 1930 the federal government had become involved, guaranteeing the pools' advances and assuming control of the Central Selling Agency (p. 249). The federal government appointed J.I. McFarland as General Manager of the CSA with the key responsibility of disposing the pool stocks. The overseas offices were closed and by June 1931 McFarland had liquidated the entire crop (Fowke 1957, p. 251). The pools operated on a voluntary basis for the next four years until the establishment of the Canadian Wheat Board in 1935.

### **5.5. Canadian Wheat Board**

During the depression years of the 1930s wheat prices dipped below \$0.40 per bushel; these were truly years of economic hardship for Prairie farmers. With the dissolution of compulsory pooling in 1931, "Pool officials turned to the federal government with a request for the restoration of a national wheat board" (Fowke 1957, p. 252). The federal government had always felt the open market and WGE were the right

instruments to facilitate cash and futures trading (Fowke 1957, p. 199). Producers wanted government control and a re-establishment of the Canadian Wheat Board that had operated from 1919-1920. Lobbying efforts by western agricultural leaders, western premiers, and pool leaders led to the CWB's re-establishment in 1935. A desirable feature of the CWB was the initial price, which served as a price floor, and a government guarantee to cover any losses should the realized price drop below the initial. In 1935 the CWB was voluntary which led producers to cherry-pick between the open and pooling market. The dual market resulted in losses in 1935 and 1938 and no deliveries in 1936 and 1937 because the open market price was higher than the CWB initial. The government attempted to rid itself of the responsibility for marketing western grain but it was met with "a storm of protest from the West" (Fowke 1957, p. 268). The federal government tried to get out of wheat selling but failed.

The start of World War II meant Europe was out of the export market leaving a large wheat market to contend with. The CWB had been committed to "Mutual Aid" and bulk sales to Britain. In order to meet these commitments the CWB was granted monopoly on the marketing of wheat in 1943; oats and barley were added in 1949 (Fowke 1957; p. 278). Multi-year international export agreements in 1946 and 1949 signaled that the CWB was here to stay. In the 1960s the CWB began signing multi-year multi-million tonne sale agreements with nations such as China and the Soviet Union (CWB website). Export agreements still continue to be signed between the CWB and nations such as China.

## 5.6. Unprofitable Statutory Rates

The advent of long-haul trucking of goods in the 1950s meant a greater share of the railways' business was hauling grain – a money-losing business according to the railways. Small wooden-crib elevators with one-time capacities of 30,000 bushels scattered the prairies because they had to be within a day's travel of the farm during the horse and wagon days (Weatherald 2004). Essentially the Prairies had a network of elevators up and down miles of branch lines with the aim of being six to ten miles apart. At the peak there were 5,474 licensed elevators and each required three turnovers per year to remain profitable (Fowke 1957, p. 129).

Serving all the branch lines at 1925 rates was no longer tolerable to the railways. The downside was that if railways began to remove service, the elevators would have to consolidate. The *Snively Commission on the Cost of Moving Grain by Rail* (1975) estimated that the cost of transporting grain was 2.6 times higher than the statutory rate being paid by producers (Snively 1976, p. 205). The statutory rates only covered 38 percent of the total rail costs of grain movement so railways were incurring annual losses of \$89 million by carrying grain (Harvey 1980). By 1977, the distribution of railway costs was farmers, 32.4 percent; government, 18 percent; and railways, 49.6 percent (Harvey 1980, p. 8).

Rail companies began to renege on branch line maintenance; major delays and a lack of capacity became major problems for grain transportation. Pressures heightened on the federal government and provincial governments of Alberta and Saskatchewan to invest in rolling stock and branch line upgrades. Between 1972 and 1986 the federal government acquired 14,000 hopper cars for use in western Canadian grain handling

(Estey 1998, p. 28). The Canadian Wheat Board purchased and entered long-term leases on 4,000 hopper cars and the provincial governments of Alberta and Saskatchewan each purchased 2,000 cars (Estey 1998, p. 28).<sup>3</sup>

The *MacPherson Commission* (1959-1961) raised the issue of branch line abandonment and the Commission's recommendations led to the *National Transportation Act* (1967). Prior to 1933, railways were allowed to abandon branch lines at will; under the *National Transportation Act* the government instituted a moratorium on branch line abandonment (Hall 1977, p. 53). In December 1974, a basic network of 12,413 miles of track was protected until 2000 and another 6,283 miles was protected until 1976 (Hall 1977, p. 60). As compensation for maintaining service on branch lines that railways were prohibited from closing, the federal government subsidized the operating costs and assumed the rehabilitation of guaranteed lines. The *Hall Commission* (1975-1977) was responsible for determining an action plan on the 6,283 miles protected until January 1, 1976. The Hall Commission recommended 2,165 miles be abandoned over the next three years, 1,813 miles be protected under the basic network until 2000, and 2,344 miles be placed under the Prairie Rail Authority (Hall 1977, p. 521).

### **5.7. Producer-Ownership: WIT**

The 1970s was also a time when the lobbying groups became strongly divided on grain handling issues. The Palliser Wheat Growers, later known as the Western Canadian Wheat Grower's Association, formed in 1970. This group of farmers felt there were inefficiencies in grain handling; elevators were viewed as being rewarded for storage

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<sup>3</sup> In the 1996 Federal budget the government stated interested in selling its hopper cars. The railways and the Farmer Rail Car Coalition have wanted to purchase the cars but no deal has come to pass. In May 2006, the Federal government announced it is retaining its hopper fleet (FRCC website).



rather than for grain movement (Driver 2001). Several issues drove farmers to enter the grain handling business. They believed wheat should be graded on the basis of protein levels (higher protein should obtain a premium) (Herman 2003, p. 37). Cleaning grain to export standards was seen as an activity that should occur at point of origin so that farmers would not pay freight on dockage and could sell the dockage as feed on the Prairies. Lastly, the ability to load unit trains (25 or more cars) was seen as an efficiency gain for the system; this view was one that the railways shared (they had rail incentives implemented in the 1983 *Western Grain Transportation Act*) (Herman 2003).

The Palliser Wheat Growers felt they were not receiving the service they deserved and they were “hungry for a more responsive, competitive system” (Herman 2003, p. 37). In its early stages of development, the terminal group was met with opposition from SWP, National Farmer’s Union, the provincial government, and churches along with support from some in federal government (Herman 2003, p. 38). The opposition stemmed from the belief that inland terminals would drive consolidation and bring an end to the CWB, small towns and rail lines. Inland terminals were not a novel idea; the United States already had at least one hundred inland terminals in operation and an additional five to seven were being constructed each month (Herman 2003, p. 35). In spite of this opposition, 1,450 farmer-shareholders moved ahead with the building of the first producer-owned inland terminal in Canada. The one-million bushel inland terminal, Weyburn Inland Terminal Inc. (WIT) officially opened for business on November 4, 1976.

Weyburn Inland Terminal (WIT) had its first handling agreement with Cargill. Cargill was also new to western Canadian grain handling having just entered through its

1974 purchase of National Grain Ltd. (Fairbairn 1984). Cargill and WIT were in agreement until 1980, when UGG made an arrangement with WIT (Driver 2001).

Financial difficulties experienced early on nearly led to WIT being purchased by SWP in 1986 (Herman 2003, p. 42). The Weyburn Inland Terminal is in its 30<sup>th</sup> year of business, has no long-term debt and net income of \$2.7 million (WIT Annual Report 2005). Weyburn Inland was the first of eleven inland terminals built in Saskatchewan. Sixteen years passed before a second producer-owned inland terminal was built in the province; ten terminals were then built over a 9-year span.

## **5.8. Crow rate debate**

Interest in abolishing the Crow Rate initially surfaced in 1974 when Otto Lang, the Minister responsible for the Canadian Wheat Board, commented that the Crow Rate was a detriment to railroads and producers (Khakbazan 1999). Livestock producers agreed with Minister Lang that the Crow Rate discouraged feed grains from remaining on the Prairies to be used as a cheap feed source for the developing livestock sector (Fulton *et al* 1998; Tyrchniewicz 1984; Rosaasen 1983; Wilson 1983). Indeed the Snavely (1973-75) and Hall (1975-77) Commissions revealed the railways were losing money moving grain because farmers only paid “one half-cent per ton per mile” which accounted for only 38 percent of the total cost to ship grain to port position (Ewins 1981a; Harvey 1980). The *Snavely Commission* estimated railway losses from handling grain totaled \$89.3 million in 1974 (Snavely 1976, p. 206).

There was strong opposition to changing the Crow Rate. The Transportation Agency of Saskatchewan published books in 1977 entitled “Why The Crow Can’t Go” (Khakbazan 1999). Pool delegates openly voiced their opposition to Crow Rate change.

Nevertheless, in March 1980, Transport Minister Luc Pépin launched an effort to revise the Crow Rate. There was a realization among farmers that freight rate change was inevitable; the result was that Pool delegates accepted the impending reality, knowing that inflexibility would lock them out of discussions. At the Pool's annual meeting in November 1980, delegates voted in favour of negotiation.

The Pool's change in position did not sit well with the National Farmer's Union (NFU) or the Saskatchewan government. The NFU, in partnership with the Saskatchewan government, hosted a "Keep the Crow Rally" and encouraged Pool members to vote out delegates who supported the Crow negotiations (Ewins 1981b). The NFU even passed a resolution asking for Pool President Ted Turner to resign because of his decision to negotiate on the Crow Rate. The Saskatchewan Agriculture Minister (MacMurchy) publicly stated that the Crow Rate was a deal for the West from confederation and it must remain in place "for all time" (Ewins 1981b).

#### *5.8.1. Gilson Recommendations*

In February 1982, Clay Gilson was appointed to negotiate with farmers to develop a consensus among farm groups on a transportation policy (Fairbairn 1984). The Pool came to the table with seven points that had to be met before the Pool would engage in negotiations. The Pool wanted the Crow rate extended to all Canadian grains and processed agriculture products, the rates were to remain statutory and distance-related, any short falls were to be paid directly to railways, and there should be a federal government guarantee on railway performance, branch line upgrades and rolling stock (SWP Comm. Division 1982). A policy incorporating these seven points was viewed by some as "totally unrealistic and hopelessly contradictory" (Fairbairn 1984, p. 227).

Gilson released his report and recommendations four months later. The recommendations called for the farmers to pay increasing portions of the costs. A volume cap of 30.4 million tonnes was also included in the recommendations. An annual \$644.1 million payment to cover freight costs would be paid to farmers (Fairbairn 1984, p. 231). Using the Gilson recommendations, Pepin announced the new transportation policy which included direct payments to farmers, with producers covering 81 percent of the costs by 1990, and incentive rates (Tyrchniewicz 1984; SWP Comm. Division 1983). The Pool described Pepin's policy as "a cruel blow to western agriculture" and Pool members vowed to "actively try to influence the thinking of all MPs" (SWP Comm. Division 1983).

The Prairie Pools with support from Quebec lobbied the government all winter long which led to a revision of the proposal due to a "wall of opposition" (Norrie 1983). Instead of the subsidy being paid to farmers, it would now be paid directly to the railways – one of the Pool's seven requirements. Freight rates would be linked to grain prices and special crops and their products would be included under the statutory rates. While this pleased Pool members, the Prairie Farm Commodity Coalition, UGG, and the Manitoba Farm Bureau were angered that the subsidy would not be paid directly to producers. The farm lobby groups were out-lobbied by the Pools and a rivalry emerged between them. Pool Vice President Garf Stevenson publicly commented that paying the railways is what grain farmers want; "the commodity coalition lost the argument and the sooner they accept that the better" (Wilson 1983).

### 5.8.2. *Western Grain Transportation Act*

The *Western Grain Transportation Act* (Bill C-155) replaced the Crow Rate on August 1, 1984. The Act provided for a payment amounting to the 1981-82 railway revenue shortfall of \$658.6 million to be paid annually by governments to railway (Vercammen 1996a). This annual subsidy was known as the Crow Benefit. The WGTA incorporated distance-based rates, which meant that all delivery points with the same hauling distance to port had the same maximum rate per tonne. For example, all delivery points 976 to 1,000 miles from port position had the same freight rate (\$32.07 per tonne) regardless of whether the point was on a low-cost mainline or a high-cost branch line (Vercammen 1996a). The rates also included a 20 percent contribution to the railways' fixed assets (Vercammen 1996a). Government contributions decreased over the next decade until contributions were 48.3 of the total freight charge by 1995-96 (Vercammen 1996a, p. 3).

Incentive rates that favoured 25-plus car units were included in the WGTA, which encouraged consolidation of the elevator network. As part of the WGTA, the National Transportation Agency monitored railway performance and reviewed rail abandonment requests. Three-year branch line plan submissions were part of the rail abandonment process and were intended to be a paperwork hurdle that would discourage branch closures (Transport Canada 1999b; Fulton *et al* 1998).

## **5.9. Government Support and Trade Agreements**

Agricultural policy and agricultural protection has a 200-year history throughout Europe and North America (Fulton and Storey 1990). For example, in the early 1800s both France and Great Britain had import duties on grain (p. 198). Governments were in

the pursuit of free trade in the early 20<sup>th</sup> Century, but that changed after the Great Depression of the 1930s. Governments wanted to avoid a repeat of the economic burdens experienced by farmers in the Depression years, so they discarded the opinion that the open market should control agriculture and began to extend financial support to farmers (Fulton and Storey 1990, p. 202-203). Throughout Europe and North America government financial support was extended to support farm prices and incomes.

The 1962 introduction of the Common Agriculture Policy (CAP) enabled the European Community to move from being a net importer to a net exporter by the 1982-83 crop year. In 1984, the U.S. introduced the Export Enhancement Program in order to fight for market share (Fulton and Storey 1990, p. 205). A price subsidy war between the United States and Europe from 1985 to 1990, negatively affected world grain prices. The federal government announced the Special Canadian Grains Program in 1986, which would see a \$1 billion deficiency payment go to grain farmers to compensate for the lower prices resulting from the US-EC price wars (Rosaasen *et al* 1990).<sup>4</sup> This program was replaced with GRIP (Gross Revenue Insurance Program) and NISA (Net Income Stabilization Act) in 1991. These price support programs were implemented to stabilize producer revenues and counter the massive grain subsidies in Europe and United States.<sup>5</sup>

Trade agreements between Canada, United States and Mexico began in the late 1980s. The Canada-United States Free Trade Agreement (CUSTA or FTA) was implemented on January 1, 1989; its aim was to eliminate tariffs over the next ten years, increase market access and decrease subsidies. In January 1994, through the North

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<sup>4</sup> This program was extended and increased in 1987. In 1986, lentil, pea, mustard, and canaryseed acres were excluded (Rosaasen *et al* 1990, p. 13).

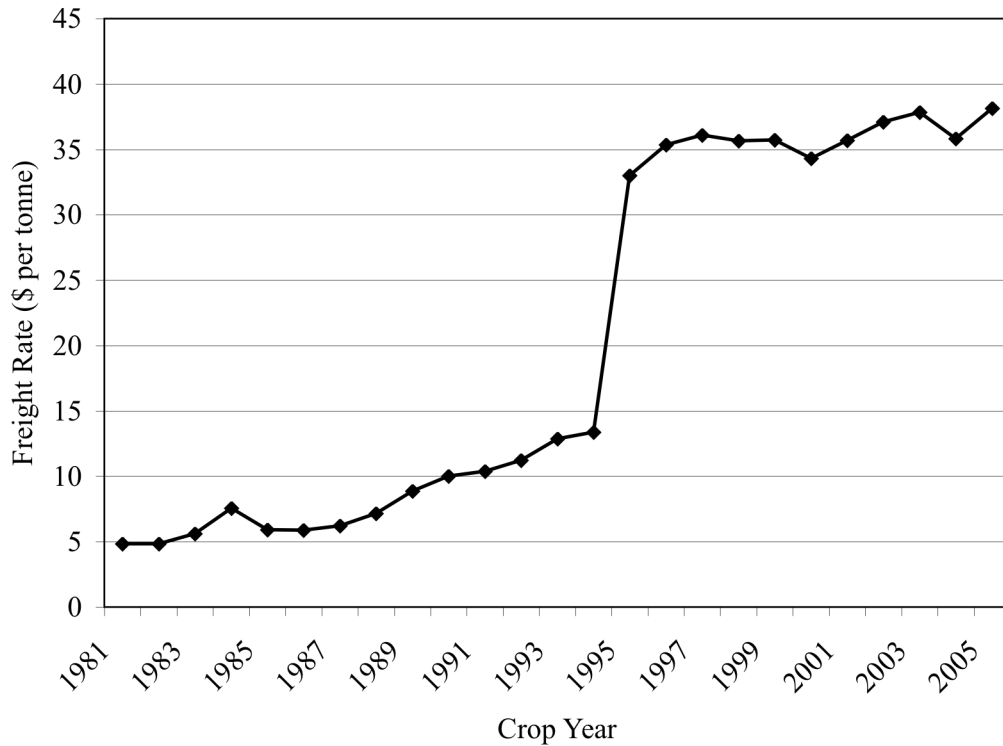
<sup>5</sup> AIDA (Agriculture Income Disaster Assistance) was offered from 1999 to 2000 when it was replaced by CFIP (Canadian Farm Income Program) which ran from 2000-2002. CAIS (Canadian Agriculture Income Stabilization) replaced CFIP and NISA in 2003.

American Free Trade Agreement (NAFTA), Mexico was added to the free trade agreement between Canada and the United States resulting in the world's largest free trade bloc. In the same year the Uruguay Round's GATT (General Agreement on Tariffs and Trade) became embodied in the World Trade Organization (WTO). The Doha Round of WTO negotiations began in November 2001 and extend beyond the timeframe of interest for this research. The goal of all these agreements was to reduce and eventually remove barriers to trade such as tariffs and producer subsidies.

#### **5.10. WGTA Abolished**

The WGTA was abolished August 1, 1995. The Crow Benefit was considered an export subsidy by the international community and therefore not acceptable under GATT (Vercammen 1996a, p. 3). In addition, the "transportation subsidy was also a sizable financial commitment for a cash-strapped federal government...that was no longer able or willing to maintain its financial commitment to grain producers" (Vercammen 1996a, p. 3; Department of Finance 1995). Farmers received a one-time payout of \$1.6 billion to compensate for the loss of the WGTA. The Canada Transportation Agency (CTA) was put in place under Bill C-14. Railways now had greater freedom to restructure rates and to abandon grain dependent branch lines. Maximum freight rates were set by the CTA for the first five years. Upon the removal of the subsidy, freight rates paid by farmers more than doubled in the first year. Figure 5.1 shows the freight rate paid by farmers for wheat shipped from Saskatoon to Thunder Bay/St. Lawrence; rates more than doubled, increasing from \$13.37 per tonne in 1994-95 to \$35.01 per tonne in the 1995-96 crop year. For Board grains, the CWB implemented a catchment area approach to calculate basis deductions and ended the pooling of seaway costs (Gray 1996).

As of August 1, 2000 railways adhere to a revenue cap set by the CTA. Railways are also encouraged to provide one-year's notice of branch line closures.



**Figure 5.1. Wheat freight rates paid by farmers, from Saskatoon to Thunder Bay/St. Lawrence, 1981-2006.**

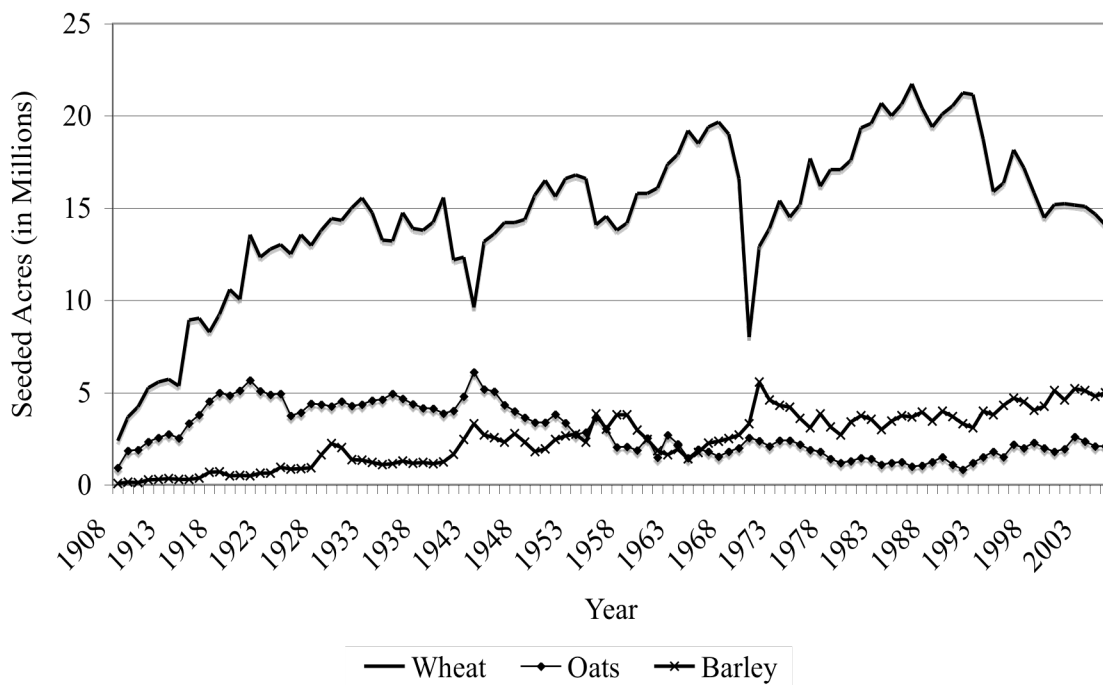
Source: SAF Agricultural Statistics.

*5.10.1. Changing cropping choices*

The increase in freight rates has farmers rethinking their transportation alternatives and their cropping choices. Increased transportation by long-haul trucking, selling to processing plants, feeding to livestock and growing higher valued crops all became viable alternatives. Wheat is the principal crop grown on the Prairies; acres sown in Saskatchewan reached a high of 21.74 million in 1986 and were a reported 14 million acres in 2005 (CANSIM). As Figure 5.2 shows wheat has always surpassed the



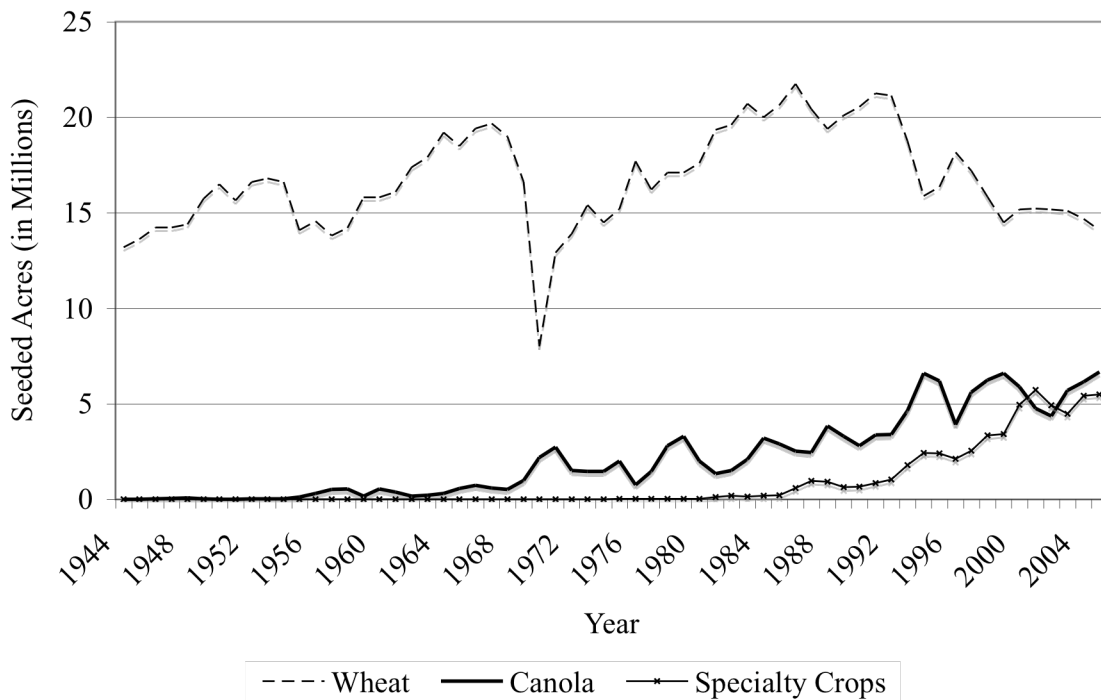
provincial acres sown to oats and barley. Regulation supported the evolution of the elevator handling system in western Canada to become efficient in the bulk handling of grain. The first movement away from cereal crops came with the emergence of rapeseed in the 1960s. By 1969, one million acres of rapeseed was planted in Saskatchewan because it was a feasible rotational crop offering higher returns to farmers (Fairbairn 1984, p. 191).



**Figure 5.2. Seeded acres of wheat, oats and barley in Saskatchewan, 1908–2005.**  
Source: CANSIM.

Next to arrive were the pulses – peas, lentils, chickpeas and beans – in the late 1970s and early 1980s. In 1980 there were 30,000 acres of field peas sown in Canada, the acres sown to lentils, chickpeas and beans were so insignificant that data was not collected (Gray and Scott 2003, p. 3). However, the latest statistics show that over 40

percent of Saskatchewan census farms include pulses in their crop rotation (Gray and Scott 2003, p. 3). Saskatchewan is the leading producer of peas, lentils and chickpeas in Canada (Saskatchewan Pulse Growers website). Pulses require special cleaning and handling as well as containerized shipment – services not available through the bulk handling elevator system – which allowed for the development of specialty crop processing plants. Today there are more than 130 specialty crop processors in Saskatchewan (Gray and Scott 2003, p. 5). Acres that were traditionally sown to cereal crops, such as wheat, began shifting into oilseed and specialty crop production as shown in Figure 5.3. As the figure indicates, spring wheat acres began a downward trend in the mid-1980s while canola and specialty crops have been increasing since the 1970s.



**Figure 5.3. Wheat, canola and specialty crop seeded acres in Saskatchewan, 1944-2005.**

Source: CANSIM

Note: Specialty crops includes seeded acres for peas, lentils, chickpeas and canary seed.

### *5.10.2. Tariff Cap Rates*

A year before the removal of the WGTA the Canadian Grain Commission (CGC) changed the way elevator tariff rates were set. Until 1994, the CGC controlled the maximum rates an elevator could charge a farmer for handling, elevation and cleaning (Fulton *et al* 1998, p. 37). Elevators are now required to file maximum fees to the CGC each crop year. Grain companies will price discriminate between provinces and locations in which they operate facilities. For several years, grain companies would have lower tariffs in Saskatchewan than in Alberta or Manitoba because they had to keep their tariffs in line with what SWP was charging. By 2000, companies began to set standard fees for all their facilities across western Canada and producers were compensated with trucking allowances as they seemed to react more favorably to a trucking incentive than to lower handling fees (Pratt 2000).

### *5.10.3. The Estey-Kroeger Process*

In December 1997, Justice Willard Estey was appointed by the Minister of Transport to conduct a review of the grain handling and transportation system with the intention of making the system more commercially oriented (Transport Canada 1999a). The Estey report (released December 21, 1998) had fifteen key recommendations. Recommendations included: 1) clean grain to export standards on the Prairies; 2) discontinue the Car Allocation Policy Group; 4) modify the cap on rail freight rates; 5) increase entry access for potential rail service providers, and; 6) eliminate harvest quota (Transport Canada 1999b). Recommendation 14 called for the CWB to no longer have an operational or commercial role in grain handling and transportation; instead grain

companies would bid on tenders to carry out the collection of grain from farmers and movement of grain to port for CWB sales contracts (Estey Final Report, p. 55).

Mr. Arthur Kroeger was appointed in May 1999 to manage a consultative process to implement twelve of the fifteen recommendations by the start of the 2000-01 crop year (Transport Canada 1999a).<sup>6</sup> The Estey-Kroeger recommendations resulted in Bill C-34, which amended the Canada Transportation Act and made way for change in grain handling and transportation in western Canada. Bill C-34 resulted in caps for railway revenue generated from grain transportation. Another outcome was grain tendering; in finding a way to implement Recommendation 14 the Working Group on Commercial Relations suggested the CWB retain its role in grain handling and transportation but also introduce tendering and performance awards based on a grain company's share of producer deliveries (Kroeger Report 1999). A 3-year memorandum of understanding between the CWB, the Western Grain Elevators' Association (WGEA) and the Inland Terminals Association of Canada (ITAC) to tender 25 percent of grain cars and use zone allocation for the non-tendered cars resulted.<sup>7</sup> Tendering works in conjunction with incentive rates; grain companies make bids to guarantee cars and to qualify for rail freight rebates ranging from \$0.75 per tonne for loading 25 cars to \$3.00 per tonne for loading 100 cars (Vercammen 1996b).

Lastly, a provision for easier access for new rail operators has seen some positive movement. Short line companies have been able to operate on abandoned branch lines that interchange at CP and CN mainlines. Great Western Railway Ltd., Southern

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<sup>6</sup> The Federal Government chose to retain three of Estey's recommendations for further review (Transport Canada 1999a).

<sup>7</sup> Tendering increased to 50 percent of sales volumes in 2002-03, but decreased to 20 percent the following crop year (and it still remains at this level) (Ewins 2003). Transportation savings were \$51 million in the 2003-04 crop year and \$26.6 million in the 2004-05 crop year (Ewins 2006a).

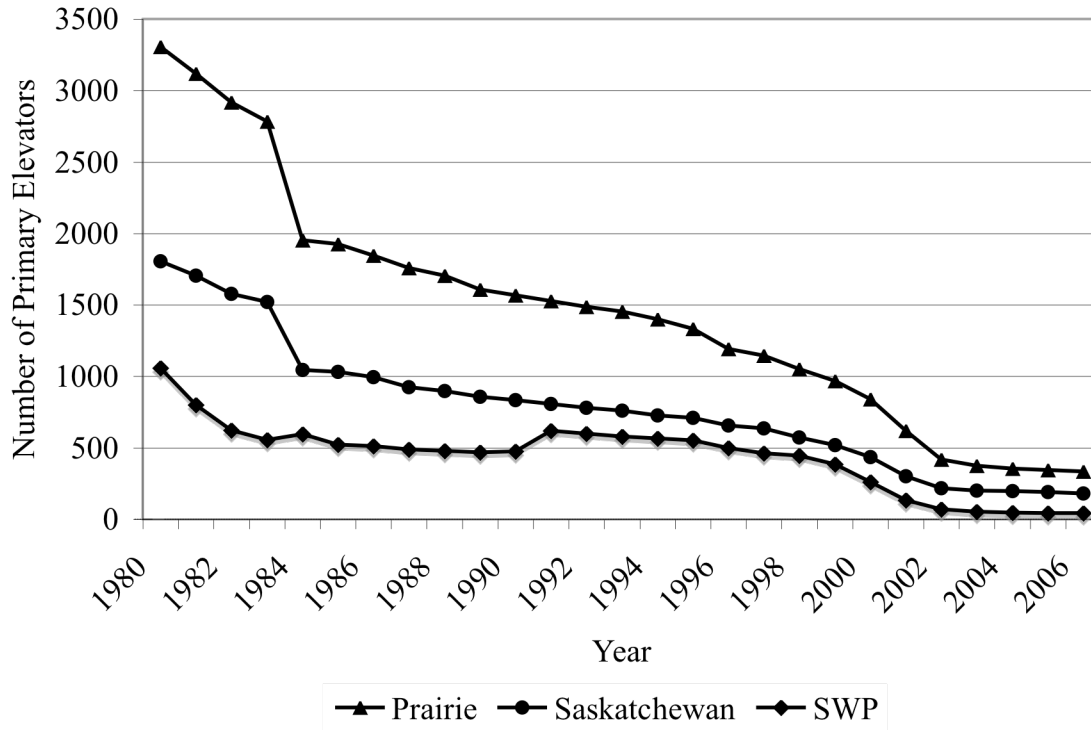
Manitoba Railway, Carlton Trail Railway, Alberta RailNet Inc., Burlington Northern (Manitoba) Ltd. and Central Western Railways are all shortline companies operating in western Canada (Railway Association of Canada website). However, CP and CN remain the only main line service providers despite applications from Ferroequus Railway and OmniTRAX (OmniTRAX website).

### **5.11. Elevator Consolidation**

Consolidation has been ongoing since the 1970s; elevators aged, farmers' method of delivering grain changed from three tonne trucks to B-trains, rail line incentives for larger train spots encouraged rationalization, and branch lines were abandoned. The pressure to consolidate increased significantly upon the removal of the WGTA in 1995. Grain dependent branch lines were no longer protected and grain companies quickly moved to rebuild their elevator networks on the main lines.

High throughput elevators that could load cleaned grain for 25 to 100 cars within 12 hours became common to the industry. Figure 5.4 shows the number of Prairie stations, Saskatchewan stations and Saskatchewan Wheat Pool stations from 1980 until 2006. Dominion Bond Rating Service in its annual report on prairie grain handling believes "the era of rampant elevator abandonment is over" (Pratt 2006). Over the last decade, licensed primary grain elevators decreased from 1,340 in 1995 to 335 in 2006. Storage capacity declined to a lesser degree from 6.6 million tonnes to 5.13 million tonnes, which reflects the closure of small elevators. Interesting to note, Cargill President Kerry Hawkins predicted in 1994 that there would be no more than 600 elevators in western Canada by 2005 (Wilson 1994). At the time, Cargill was planning to "invest

more than \$1 billion to revitalize their handling systems” over the next decade (Wilson 1994).



**Figure 5.4. Number of licensed primary elevators: Prairies, Saskatchewan, and SWP, 1980–2006.**

Source: Canadian Grain Commission; SAFRR Agricultural Statistics; SWP Annual Reports.

Note: The large drop in Prairie primary elevators from 1984 to 1985 was due a change in CGC’s reporting rules. Operators of primary elevators were now allowed to license two or more adjacent facilities under the control of a single manager as a single primary elevator.

Table 5.2 shows the top ten grain companies by primary storage capacity on the Prairies for each of the last five decades and for 2006. The top 10 grain companies have consecutively included Saskatchewan Wheat Pool, Alberta Wheat Pool and Manitoba Pool Elevators (Agricore since 1998), Parrish and Heimbecker (since 1970), Pioneer,

United Grain Growers, N.M. Paterson and Sons and Cargill (since 1980). Saskatchewan Wheat Pool consistently ranked number one and held between 24 and 28 percent of the primary storage capacity (CGC 1960; 1970; 1980; 1990; 2000). As of 2006, Agricore United held the largest percentage (24.5 percent) of primary storage capacity on the Prairies, bumping SWP to second place with 22 percent.

In western Canadian grain handling there has always been the major grain companies that owned the bulk of the primary storage capacity. In the late 1990s, however, new entrants made a strong effort to break into the industry. In 2000 Louis Dreyfus (7<sup>th</sup>) and ConAgra (9<sup>th</sup>) were ranked among the top ten grain companies on the Prairies in terms of storage capacity; these companies had entered the grain handling industry in western Canada two years earlier. The producer terminals are reported individually in the *Grain Elevators in Canada* report, which disguises their size and presence in Saskatchewan. If considered together producer terminals owned 14.6 percent (411,110 tonnes) of the primary storage capacity in Saskatchewan in 2006, second only to Saskatchewan Wheat Pool which owns 30 percent (CGC GEIC 2006).

**Table 5.2. Top 10 Prairie grain companies by primary storage capacity, 1960-2006.<sup>a</sup>**

1960	1970	1980	1990	2000	2006
1. SWP (24%)	1. SWP (24%)	1. SWP (28%)	1. SWP (26%)	1. SWP (22.4%)	1. Agricore United (24.5%) <sup>c</sup>
2. AWP (15%)	2. Federal (20%)	2. AWP (21%)	2. AWP (20%)	2. Agricore (22%)	2. SWP (22%)
3. UGG (12%)	3. UGG (17%)	3. UGG (18%)	3. UGG (16%)	3. UGG (11.9%)	3. Pioneer (12.3%)
4. Pioneer (10%)	4. AWP (12%)	4. Pioneer (14%)	4. Pioneer (12%)	4. Pioneer (8%)	4. Cargill (9.1%)
5. Searle (8%)	5. Pioneer (10%)	5. MPE (7%)	5. MPE (8%)	5. Cargill (7.5%)	5. Paterson (6.5%)
6. Federal (7%)	6. MPE (7%)	6. Cargill (6%)	6. Cargill (6%)	6. AgPro (7.4%) <sup>b</sup>	6. Louis Dreyfus (6%)
7. MPE (6%)	7. National (6%)	7. P&H (3%)	7. P&H (3%)	7. P&H (3.7%)	7. P&H (5.8%)
8. Alta Pacific (6%)	8. Paterson (2%)	8. Paterson (3%)	8. Paterson (3%)	8. Paterson (3.7%)	8. WIT (2.1%)
9. National (6%)	9. P&H (1%)	9. WIT (0.29%)	9. AgPro (3%)	9. Louis Dreyfus (2.7%)	9. NWT (1.2%)
10. Paterson (2%)	10. Robin Hood (1%)	10. Continental (0.14%)	10. AB Terminals (2%)	10. ConAgra (1.9%)	10. Bunge (1.1%)

<sup>a</sup> Prairies includes Manitoba, Saskatchewan and Alberta.

<sup>b</sup> AgPro is a subsidiary of SWP. After 2000, its storage capacity has been included in the SWP's overall storage capacity.

<sup>c</sup> In 2001, Agricore merged with UGG to form Agricore United.

Source: Canadian Grain Commission *Grain Elevators in Canada several years*.



## 5.12. New Competition

The rebuilding and repositioning period following the removal of the WGTA enabled new entrants to enter the western Canadian grain handling industry. Existing grain companies had to relocate on main lines and increase the throughput capacity of their elevators in order to qualify for unit train rebates from the railways. At the same time multinational companies, namely ConAgra, Louis Dreyfus, ADM and Bunge, along with producer-owned inland terminals began springing up across the Prairies and adding to the competition mix.

### 5.12.1. *Producer-owned inland terminals*

Sixteen years after WIT started operations, a second producer-owned terminal – North East Terminal (NET) – opened near Wadena, Saskatchewan in 1992. The reason for the 16-year lag between WIT and the ten other terminals was because farmer investors wanted a “proven record of success at WIT before embarking on their own” initiative (Herman 2003, p. 44). Many of the inlands partnered with existing industry players in order to gain access to port facilities; Cargill partnered on four of the facilities and Agricore United on two terminals (Herman 2003). Table 5.3 lists the producer-owned inland terminals in Saskatchewan, including the year they began operation, their storage capacity and any joint owners at time of start up.

In an attempt to remove the reliance on grain companies for port access, five producer-owned inland terminals – Terminal One – made a bid on the old UGG terminal at the port of Vancouver in early 2005. The deal fell through in August 2005 because the Terminal One group could not secure the required 1.6 million tonnes of

grain supplies. The shortage was due to many of the producer-owned inlands being locked into handling agreements with other companies at the port (Ewins 2005a; Ewins 2005d).

**Table 5.3. Producer-owned inland terminals of Saskatchewan, as of 2004.**

<b>Facility Name</b>	<b>Location</b>	<b>Year</b>	<b>Storage Capacity</b>	<b>Joint Owner</b>
CMI Terminal	Naicam	1999	23,320	Agricore United
Gardiner Dam Terminal	Loreburn	1999	17,000	Agricore United
Great Sandhills Terminal	Leader	1999	16,500	SWP
Mainline Terminal Ltd.	Moosomin	1997	31,340	Cargill
Mid-Sask Terminal	Watrous	1997	23,800	Pioneer
North East Terminal	Wadena	1992	35,920	Cargill
North West Terminal	Unity	1996	63,000	Pioneer
Prairie West Terminal	Plenty	1998	44,580	–
South West Terminal	Gull Lake	1997	52,000	Cargill
Terminal 22 (1998) Inc.	Balcarres	1998	32,500	Cargill
Weyburn Inland Terminal	Weyburn	1976	107,900	–

Source: Herman 2003; Canadian Grain Commission 2004-2005.

Note: Parrish and Heimbecker purchased Mainline Terminal in 2005.

### *5.12.2. Multinational Competitors*

In terms of multinational agribusiness companies in western Canadian grain handling, Cargill had been on the scene since 1974 with its purchase of National Grain and the construction of two large concretes in Elm Creek, Manitoba and Rosetown, Saskatchewan. Cargill is a privately owned business with headquarters in Minneapolis,

Minnesota and operations in 61 countries. Cargill started in grain storage in 1865 but has been diversifying and expanding globally since the 1950s. Annual sales revenues totaled \$71 billion in 2005 (Cargill website). In Canada, Cargill is involved in beef and poultry processing, grain handling, crop inputs, animal nutrition, malting barley (Prairie Malt), sweeteners, road salt, chocolate, egg processing and the trading of coal, weather derivatives and electricity (Cargill Canada website). Cargill AgHorizons currently operates 31 elevators in western Canada and ranks fourth in primary grain storage capacity (CGC 2006).

Archer-Daniels-Midland Company (ADM) is based out of Decatur, Illinois and generated net sales of \$35.9 billion in 2005 (ADM website). ADM is an agribusiness involved in the processing of crops into food ingredients, animal feed ingredients, nutritional products, renewable fuels and natural industrial chemicals (ADM website). To source crops for processing, ADM acquired 45 percent share of United Grain Growers (UGG) in 1997 and currently owns a 28 percent share of Agricore United. In 2004, ADM owned four primary elevators – two in Saskatchewan and two in Manitoba (CGC GEIC 2004). As of 2006, ADM only owns one elevator in each province (CGC 2006).

ConAgra Foods Inc. is headquartered in Omaha, Nebraska and is a producer of nearly 80 brands of packaged and frozen foods for retail, the foodservice industry and food processors (Murray 2005). Well-known brands include Orville Redenbacher's, Hunt's, Reddi Wip, Chef Boyardee, Healthy Choice, Pam (ConAgra Foods website). The company's annual net sales were \$11.6 billion in 2006 (ConAgra Annual Report 2006). ConAgra made the decision to move downstream to source raw product and

constructed four grain terminals in western Canada (CGC 2004). In 2005, ConAgra sold its four terminals to James Richardson International (Ewins 2005c).

Established in 1851, Louis Dreyfus is a multinational diversified company with its headquarters in Paris, France and annual sales over \$20 billion (Louis Dreyfus website). This family-owned company has operations in 53 countries; activities include the “processing, trading and merchandising of various agricultural and energy commodities” (Louis Dreyfus website). Louis Dreyfus has diversified into particleboard manufacturing, telecommunications, real estate, ocean vessels, and forestry management. This company made its debut in western Canada in 1998 with its steel bin construction. Louis Dreyfus currently owns nine elevators – three in Alberta, two in Manitoba and four in Saskatchewan – and has the sixth largest total primary storage capacity on the Prairies (CGC GEIC 2006).

Bunge is a multinational diversified company with commodity trading roots in Amsterdam, Argentina and Brazil. Bunge expanded into United States in 1935. Global headquarters were moved to White Plains, New York in 1999. The company has been diversifying up the food production chain since the 1970s. Bunge is notable in that it only handles oilseeds – flax, canola, and soybeans. Although Bunge Canada only has two primary elevators (both located in Saskatchewan) it is Canada’s largest oilseed processor with four canola processing plants in western Canada and one canola/soybean processing plant in Ontario (Bunge Canada website). Through its 2002 purchase of Cereol, Bunge acquired CanAmera (a former SWP subsidiary) allowing it to establish its oil processing network in Canada (Pratt 2002). Globally, Bunge is the world’s leading oilseed processor, the world’s largest producer and supplier of fertilizer to South

American farmers, and the world's leading seller of bottled vegetable oils. In 2005, Bunge's net sales were \$24 billion (Bunge website).

As of August 1, 2006 ADM, Bunge and Louis Dreyfus together accounted for 14 primary elevators (4 percent of Prairie elevators) averaging 28,640 tonnes storage capacity for a total of 401,000 tonnes of storage capacity (7.8 percent of the total Prairie storage capacity). In less than ten years these companies were able to successfully enter western Canada and provide strong competition in the grains and oilseeds handling industry. By choosing to enter western Canada at the peak of deregulation and consolidation, the companies were able to build at viable points on the main lines.

### **5.13. Challenges to CWB**

Challenges to the CWB's grain marketing monopoly arose in the 1990s. Some producers wanted more say in the CWB's affairs while others wanted the CWB's single desk selling powers to be removed entirely. Producers began to question the CWB's marketing powers, wanting more choice on where to market their wheat and barley.<sup>8</sup> In November 1995, an Alberta farmer plebiscite found 66 percent in favour of a dual-market for barley and 62 percent in favour of a dual-market for wheat (MacArthur 1996). Several producers were charged and even spent time in jail for trying to haul grain into the U.S. without CWB export permits, unlawfully taking seized trucks from Canada Customs compounds, and protesting at a Lyleton, Manitoba border crossing (Tjaden 1997; Rampton 1996). The Western Canadian Wheat Growers Association, Farmers for Justice, the National Farmer's Union and Citizens Concerned About Free Trade

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<sup>8</sup> In 1989, oats was removed from CWB control. In 1993, the federal government instituted a continental barley market for a period of 30 days (Schmitz *et al*, 1997).

(CCAFT) were some of the groups that were key in driving the debate on the CWB's future.

The CWB had been a crown agency overseen by five Commissioners – three were federally appointed. Bill C-4 was passed in June 1998 giving producers more control over the direction of the CWB. In December 1998, the CWB began operating with a shared governance structure, a farmer-elected board of directors and an appointed CEO. The fifteen-member board has ten farmer-elected members and five federally appointed members (President, CEO and three others). This legislation brought about the most dramatic changes the CWB had seen in nearly half a century.

#### *5.13.1. Trade agreements challenge CWB*

The CWB's single-desk marketing has come under scrutiny from the United States ever since the signing of the FTA in 1989. The U.S. government has alleged that Canadian durum wheat exports are in violation of the agreement. In 1993, the North Dakota Wheat Commission accused the CWB of using freight subsidies and predatory pricing to gain unfair trade advantages (Dakers and Frechette 1998). In mid-January 1994, the United States requested the International Trade Commission review Canada's durum sales practices; only 3 of 105 sales were at prices below the U.S. price. Since 1990, legal costs for the fourteen U.S. trade challenges brought against the CWB have cost \$17 million.

Under the WTO, the CWB is viewed as a state-trading enterprise. The United States and European Union are arguing that state-trading enterprises qualify as export subsidies; essentially the U.S. and E.U. want to see an end to the CWB. The 2004 WTO Framework Agreement explicitly states that there needs to be an elimination of export

subsidies, export credit guarantees, government financing, and exporting state trading enterprises (WTO 2004). There is a current commitment to end export subsidies by 2013, which will include the removal of the government guarantee on initial payments and borrowings (CWB website).

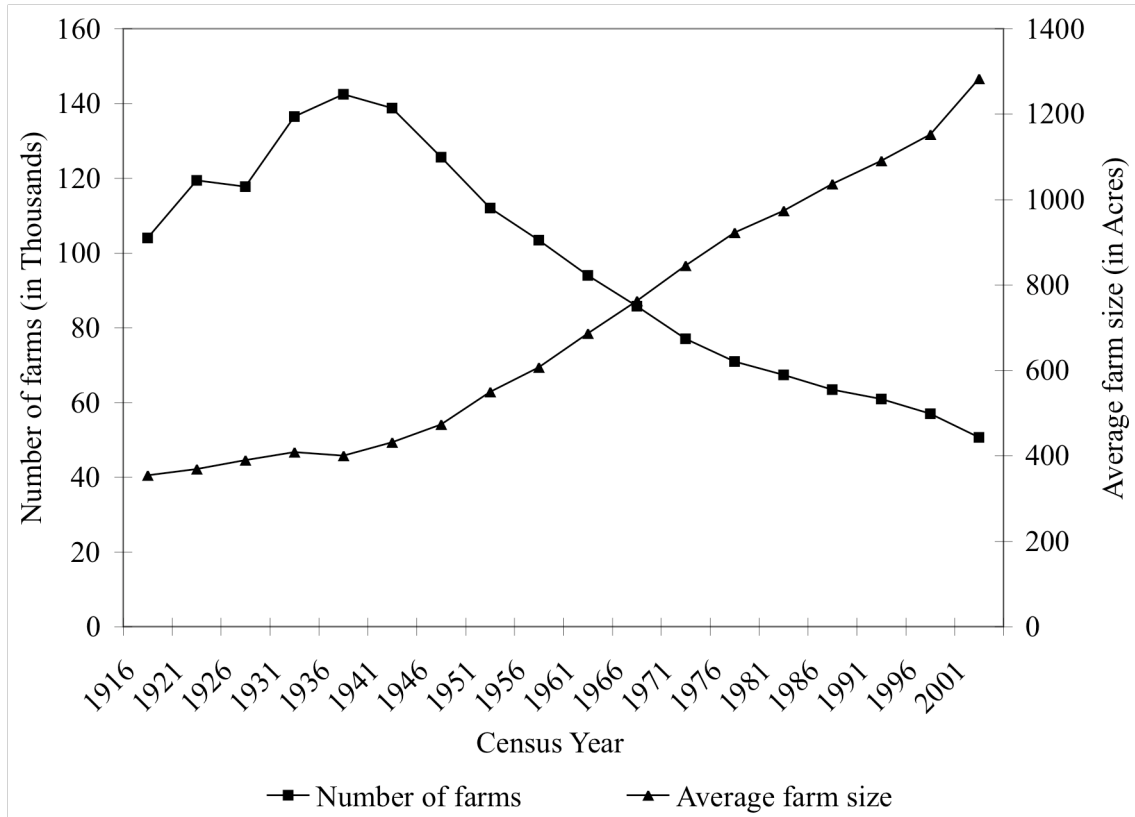
The current Conservative government has expressed desire to see the removal of the CWB by July 2008 (Migie *et al* 2006), but farmers have strongly indicated that the CWB's fate should remain a decision for farmers to make (Ewins 2006c).<sup>9</sup> The CWB Act requires a vote by producers to end the single desk. The changes being proposed for the CWB make for interesting and uncertain times in the agriculture industry.

#### **5.14. Farm Demographics**

Farmer demographics have also been changing – average age, education and farm size are all increasing (AAFC 2005). Figure 5.5 shows the number of farms in Saskatchewan (in Census years) and the average farm size in acres from 1916 to 2001. The number of farms peaked at 142,391 in 1936 and has declined by 64 percent over the last 65 years to 50,598 in 2001. By 2001 the average Saskatchewan farm had reached 1,280 acres in size, up from 845 acres in 1971. The average farm size has increased by over 360 percent from 1916 to 2001. Some people in the agriculture industry suggest average farm size will reach 3,000 to 5,000 acres and will be corporate farms rather than the traditional family-owned and operated farm (Paul *et al* 2004). Furtan (2006) suggests farms ranging from 30,000 to 50,000 acres may become the average if the current trend towards an industrial farm structure continues.

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<sup>9</sup> Federal Agriculture Minister Chuck Strahl announced in November 2006 that a producer plebiscite will be held for barley in January 2007 (AAFC website). To date there has been no mention for a plebiscite on wheat.



**Figure 5.5. Number of farms and average farm size in Saskatchewan, 1916–2001.**

Source: SAF Agricultural Statistics.

The level of education obtained by farmers has also increased. The 1996 Census reports that 37 percent of Saskatchewan farm operators have post-secondary education. In the 2001 Census that same statistic had increased to 40 percent of Saskatchewan farm operators. Fifty percent of young farmers have some post-secondary education, which increases the potential to continue learning, adopt new management practices and increase the financial performance of an operation (AAFC). Programs by the federal government, such as the 2005 CASS (Canadian Agricultural Skills Service) provides financial support to farmers to broaden their skill set.

As profit margins decrease, farmers need the knowledge to determine optimal marketing options and prices for their commodities. Farmers will search out the best



price for their crop production and will look for grain companies to offer trucking and grade incentives (Ewins 2005b).

### **5.15. Overcapacity**

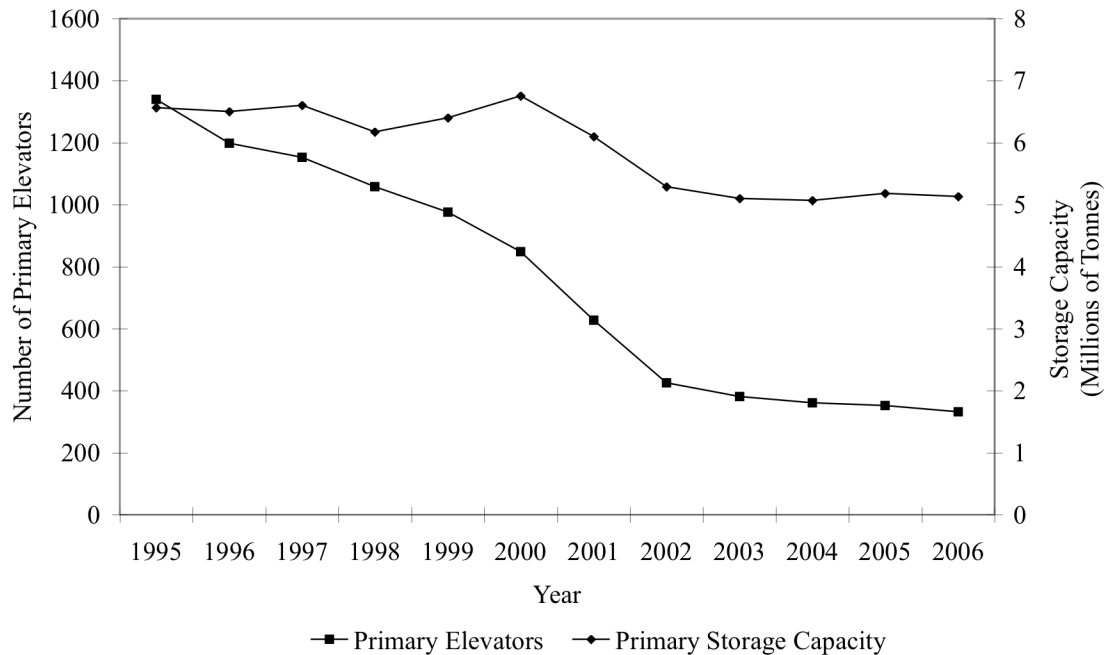
During the 1990s grain companies were relocating to main lines, producer-owned inlands were being built and American multinationals were entering the Prairies. As grain companies opened high throughput elevators (HTE) they had to close their smaller wooden facilities. Closing the older elevators on branch lines and relocating to the main lines was not an overnight job. The process was lengthy and it led to industry being overbuilt (Schroeder and Chim 2003; Schroeder *et al* 2001). Closures were delayed as grain companies attempted to lessen the producer backlash. The Pool especially found that “some of the most loyal pool members [began] delivering to other companies” because they were angry that their local facilities were being closed (Briere 2000). Continuing the closure of smaller elevators incapable of loading a minimum of 25 cars would alleviate some of the overcapacity, but it was believed that there had also been over-construction of high throughput elevators.

A typical HTE averages 25,000 metric tonnes storage capacity and can load 50 or more cars in 8 to 12 hours (CGC FAQ 2004; Schroeder and Chim 2003). For an HTE to breakeven it should turnover its capacity at least 10 times (Schroeder and Chim 2003). As of August 1, 2006 74 elevators on the Prairies qualified as HTE's on the basis of storage capacity (>25,000 tonnes) and accounted for 54 percent (2.8 million metric tonnes) of the total Prairie storage capacity (CGC GEIC 2006).

Figure 5.6 shows the number of primary elevators and storage capacity on the Prairies from 1995 to 2005. The number of primary elevators increased slightly in the

first two years but has continually decreased since 1997. As the graph shows, the number of elevators has decreased 74 percent from 1995 to 2005 while storage capacity has only decreased 21 percent. Dominion Bond Rating Service is now saying “the bulk of the rationalization is complete” (Ewins 2006b). DBRS’s Anil Passi believes another round of consolidation could be expected if there is “deregulation of the rail car allocation and grain marketing systems” (Ewins 2006b). Agricore United, SWP, and Pioneer control a commanding 75 percent of the prairie grain handling market share (Ewins 2006b).

With the changes being proposed to the CWB, there is likely to be ramifications to all areas of the grain industry that could trigger another round of consolidation. On November 7, 2006 the Pool announced its intentions to make a bid to purchase Agricore United; the formal bid was sent on November 28, 2006 (SWP News Release). Agricore United has publicly announced it will formally reject the Pool’s hostile takeover bid (Ewins 2006d). These merger discussions are an example of the consolidation Passi was describing.



**Figure 5.6. Prairie primary elevators and storage capacity, 1995-2005.**

Source: CGC Grain *Elevators in Canada* 2006.

Note: The large drop in Prairie primary elevators from 1984 to 1985 was due a change in CGC’s reporting rules. Operators of primary elevators were now allowed to license two or more adjacent facilities under the control of a single manager as a single primary elevator.

### 5.16. Summary

The only thing constant is change; this statement is fitting for the grain industry which has been evolving and modifying since its inception. It is impossible to describe all the changes that the grain handling companies have faced in the last century, let alone the last few decades. From the agrarian protest for government involvement in grain handling in the early 1900s to the Crow rate change of the mid-1980s to the CWB debates of the 1990s, producers have played a key role in shaping the grain industry of today. Lobbying resulted in regulations and regulatory bodies, the WGTA, CGC, CWB, and CTA which

foster and support the Prairie grain economy. Producers wanted to be rewarded on the basis of protein and to clean grain before shipping instead of being penalized at port for the dockage; these practices became increasingly common because producers set the example by opening their own inland terminal to meet these needs. Producer lobbying staved off for awhile the removal of the WGTA and hence the wave of rail line abandonment that would ensue which gave grain companies a little extra time to determine a game plan on how to rebuild their elevator networks.

This chapter surveyed the major regulatory changes in grain handling throughout the 1980s and 1990s. Of central importance to this research project is how the grain handling companies, and specifically the Pool, adapted to the new environment that emerged. The changes were drastic enough that business models did not exist for the grain industry that was emerging and grain handling companies needed to develop new models based on changes that had occurred and that were anticipated.

The shift to differential freight rates and the end to branchline protection forced grain companies to rebuild their elevator networks. The removal of freight rate subsidies had been on the horizon since the early 1980s. It was expected that livestock production and value-added processing would flourish on the Prairies as the price of grain fell with the removal of the subsidy. Grain companies, like the Pool, invested in feed mills and intensive livestock production based on these expectations. The removal of the WGTA in 1995 led to a new playing field for grain companies. A new elevator network with new players and new rules for competition had to be learned. Trucking incentives are one example of how grain companies now have to compete for producers' business. The car

tendering process also challenges grain companies to be competitive; an elevator must prove it can bring in grain and be cost-efficient if it wants to receive cars.

Government's desire to be less involved in agriculture and to let market forces determine outcomes had wide-ranging implications. Canada's signing of trade agreements such as CUSTA and NAFTA has led and will continue to lead to increased vertical and horizontal coordination, decreased government support and structural changes in agriculture production as comparative and competitive advantages are realized. For example, the signing of CUSTA and NAFTA has led to a single Canada-United States malt barley market as import restrictions and tariffs were reduced (Buschena *et al* 1998). Not only did the type of barley grown in Canada change (more 2-row sown than 6-row), but the industry players shifted. Several U.S. firms acquired interest in Canadian firms; the number of firms was cut in half and eight firms now control 97 percent of malt production in the United States and Canada (Buschena *et al* 1998, p.7).

There were opportunities on the horizon that grain companies with the capacity to challenge assumptions and revise their cognitive models may have been able to anticipate. One opportunity was consumer demand for identity preservation and traceability. In 1995, Warburton began using identity preserved (IP) contracts with Canadian farmers to obtain specific varieties of wheat for its bakery (Kennett *et al* 1998). Segregating the IP grain from conventional grain required supply chain coordination. Grain handling in western Canada had been built to store and handle bulk grain shipments; grain companies that took the initiative to allow for segregation could capture benefits from being able to accommodate processor demand for IP grain.

Interestingly, the next wave of change is arising. In a June 22, 2006 *Western Producer* article both Agricore United and Saskatchewan Wheat Pool announced plans to expand and diversify. Both grain companies have “done an admirable job of paring themselves down to lean, mean grain handling machines”...”the infrastructures have been built out and most of the old country elevators have been closed” and now it is time to start expanding again (Pratt 2006). SWP says it is simply looking for “stand-alone opportunities or joint ventures and partnerships to expand the opportunities for our shareholders” (Pratt 2006). In December 2006, the Pool submitted a bid to purchase Agricore United (Ewins 2006d). Agricore United has reportedly invested in a dairy mineral manufacturing plant and an oat processing plant, and has purchased two independent farm supply retailers (Hursh 2006). The difficulties experienced over the last decade are not easily forgotten as Grain Services Union general secretary, Hugh Wagner, hopes the Pool’s expansion plans are executed more successfully than its last efforts (Pratt 2006).

The next chapter will review how Saskatchewan Wheat Pool responded to industry changes during the period of 1970 until 2000; a particular focus will be on its decisions and strategies in the 1990s. During the deregulation and consolidation of the 1990s the Pool made some critical investment decisions which led to financial problems. To mitigate its financial problems, the Pool underwent a large debt restructuring and divestiture from many of its diversified business lines.

## CHAPTER 6: SWP EVENTS FROM 1970–2000

### 6.1. Introduction

This chapter begins with an overview of the Pool's formation and the evolution of its democratic structure. Following this is a review of the financial and market performance of the Saskatchewan Wheat Pool over the last three decades (1970–2005). The Pool's net earnings (or losses), market share, and long-term debt will be presented to show the rise and fall of these performance indicators. As the previous chapter has shown the entire grain industry was faced with massive deregulation and consolidation in the 1990s. The Pool's response to deregulation was diversification and handling system restructuring. During this time the Pool also contended with merger discussions with the other two Pools and the eventual decision to become publicly traded in 1996.

The reason the focus is on the changes within the grain handling industry as opposed to looking at all the business lines the Pool was involved in – newspaper, oilseed processing, malt processing, farm supplies, flour milling, etc – was because the Pool's core business was grain handling. It was deregulation within the grain handling industry that forced the Pool to rebuild its handling system and increase the importance of diversification.

### 6.2. Formation of SWP

In 1923 a co-operative aficionado from the United States, Aaron Sapiro, was invited to the Prairies to speak to farmers on pooling co-operatives. Sapiro stressed that in order for a co-op to even begin operations farmers, representing a minimum 50 percent of the province's total wheat acreage, had to sign five-year delivery contracts with the Pool

(Fairbairn 1984, p. 23). The initial 1923 pooling drive in Saskatchewan fell short of its target. A second drive commenced in February 1924 and successfully led to 45,725 contract signers, representing the targeted fifty per cent of wheat acreage in Saskatchewan, being locked into five-year contracts with the pool (Fairbairn 1984, p. 40). On June 26, 1924 the Saskatchewan Wheat Pool became operational and ready to accept deliveries in the 1924-25 crop year.<sup>10</sup>

Initially the three sister Pools – Manitoba, Alberta and Saskatchewan – all marketed their grain through the Central Selling Agency and the “pooled” revenues were paid out to members. The grain was gathered by existing grain companies with which the Pool had handling contracts. Multi-year contracts with companies such as the Saskatchewan Co-operative Elevator Company were a struggle to achieve, so SWP decided to build its own elevators. The first elevator was built in Bulyea, Saskatchewan in 1925 (Fairbairn 1984, p. 63). The following year, Saskatchewan Co-operative Elevator Company sold 451 of its elevators and three terminals to the Pool on August 2, 1926 (Fairbairn 1984, p. 67). When the Central Selling Agency had its marketing authority halted by the federal government in 1931, the Pool became solely a grain handling co-operative. The Pool boasted a membership of 74,000 producers (Class A shareholders) in the 1990s and has been handling producers’ grain for over 80 years.<sup>11</sup>

### **6.3. Pool Management**

Since 1967 the Pool’s board members have appointed a Chief Executive Officer (CEO) and management group to oversee the day-to-day activities of the co-operative.

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<sup>10</sup> The official title was actually Saskatchewan Co-operative Wheat Producers; it was switched to Saskatchewan Wheat Pool in 1953 (Fairbairn 1984, p.167).

<sup>11</sup> Membership shares no longer exist because the Pool became a federal corporation in February 2005, effectively dissolving its co-operative status.



Prior to appointing a CEO, the managers from each of the Pool's operating divisions reported separately and independently to the board of directors. The management group is responsible for choosing investments for the co-operative's commercial side; the investment choices are in line with the direction set by the board members.

The Pool had a commercial and policy side until 1996. The head of the Policy Division was the Corporate Secretary. The head of the Commercial Division was the Chief Executive Officer (CEO). Both heads reported to the board members on their respective divisions and both had equal power, at least in principle. The Corporate Secretary was concerned with agriculture policy, the membership and listening to member needs. The CEO was concerned with investing retained earnings in order to generate cash flow for the co-op.

As outlined in the SWP's 1998 Annual Report the management was "responsible for the day-to-day management of the business of the corporation and for implementing the operational policies, budget and strategic plans approved by the Board" (p. 60). After the 1996 share conversion a portion of senior management's compensation was based on the achievement of performance targets.

#### **6.4. Pool's Dual Role**

The Saskatchewan Wheat Pool became well known for operating as a dual-purpose organization. Its core business was providing grain storage, grain handling and supplying crop inputs to its members and returning dollars in the form of patronage refunds. But the Pool also represented farmers on agricultural policy. The Pool undertook lobbying efforts and direct discussions with all levels of government on issues such as railway transportation costs, taxation and health services. Until the 1990s, the

Pool was widely perceived as the most powerful agricultural lobbying and interest group in the province. An example of the Pool's lobbying strength and influence on other farm groups was Federal Transport Minister P  pin's expressed relief at the Pool's acceptance to negotiate on the Crow rate in the 1980s because he knew the Pool had to be on side in order for the other grain companies to follow suit (Wilson 1980).

A shift away from policy involvement started when the Pool became publicly traded in 1996. The dual head structure did not conform to the traditional hierarchy of a corporation so the head of the Policy Division (Glen McGlaughlin) was removed from the organization's structure and the head of the Commercial Division (CEO Don Loewen) became the sole figurehead for the co-op. As a publicly traded entity the Pool became more commercially oriented to attract investors and slowly moved away from policy involvement. The visibility of the policy division substantially decreased to the point where the Pool is no longer involved in policy debate. The lobbying voice for producers has been replaced by groups such as APAS (Agricultural Producers Association of Saskatchewan) and the Canadian Wheat Board (Fulton 2006).

### **6.5. Pool's Democratic Structure**

In the SWP's democratic structure, members elected delegates in their respective sub-districts; the delegates from each district then elected a representative to the Board of Directors (2000 SWP Annual Report). Board members openly communicated with delegates to ensure that all farmer-members had their views heard by the co-operative. Delegates were made aware of any potential investments and were asked for their opinions on the impending decisions. This open dialogue and communication ceased after the share conversion in 1996 because leakage to the media and investment

community on potential investments could negatively impact share values or result in insider-trading allegations.

The mandate of the board as indicated in the SWP 1998 Annual Report is to direct the management of the business by establishing an overall strategy, “hiring skilled management who report to the Board”, “keeping informed about the Pool’s business”, and “holding management accountable for its actions” (p. 58). Up until 2000 there were sixteen farmer-elected board members representing 16 districts and 122 sub-districts (SWP Annual Report 1998). In March 2000, the Pool announced that the number of farmer-elected seats would decrease to twelve and two outside advisors would be appointed to assist board members (2001 SWP Annual Report). The intent was to add expertise in finance, banking, international trade and marketing that was potentially lacking around the board table (Ewins 2000).

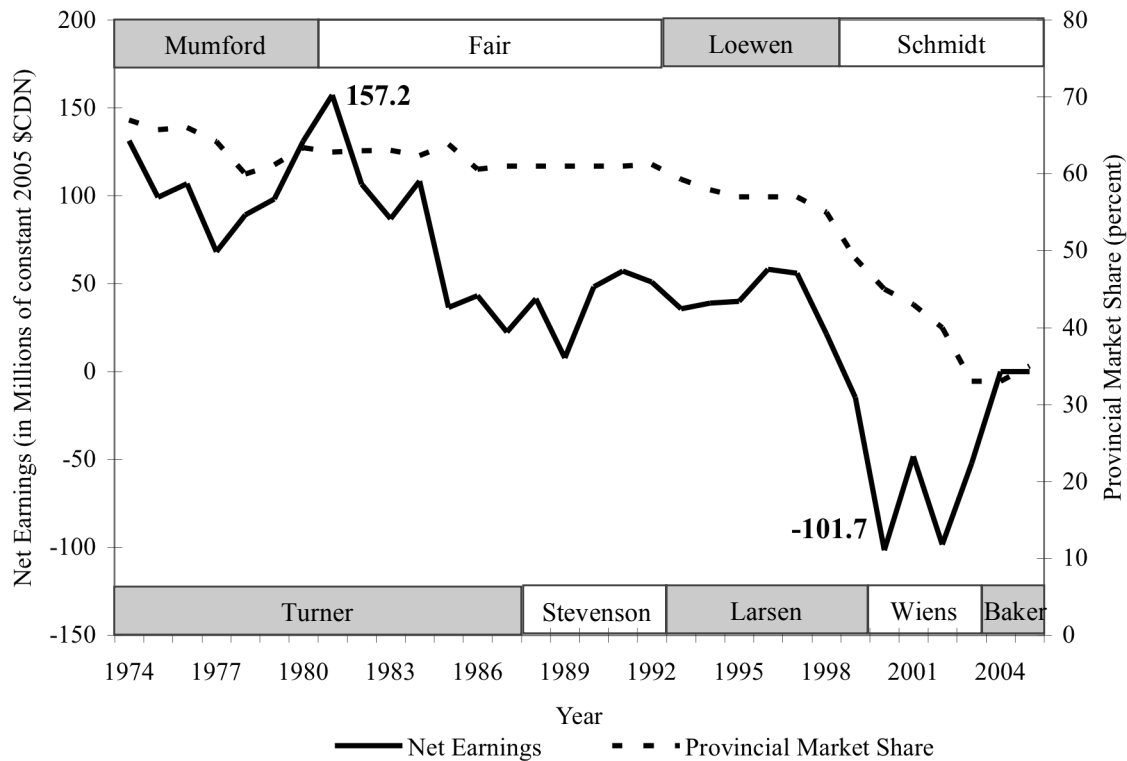
The structure was changed again in 2003, as a requirement of the SWP’s debt restructuring agreement, to eight delegate-elected board members and four independent board members elected by the delegates from a list of nominees selected by the Corporate Governance Committee (SWP Annual Report 2003). The most recent change to the board structure occurred in March 2005 when the Pool became a corporation under the Canada Business Corporations Act; the board now consists of four farmer board-members, seven appointed directors from the investment community, and the CEO (SWP News Release 2005; Sanford 2005).

## **6.6. SWP Financial and Market Performance**

Figure 6.1 shows the real net earnings and share of provincial grain handlings for SWP from 1974 to 2005. Figure 6.1 also shows the chief executive officers for the same time period along the top of the figure; the board chairmen are listed along the bottom.

The Pool's net earnings (solid line in Figure 6.1) peaked in 1981 at \$157.2 million (constant 2005 Canadian dollars). Net earnings continually declined from 1982 onward to a low of \$7.7 million in 1989. There was a modest recovery in earnings throughout the 1990s as net earnings ranged between \$21.3 and \$58.1 million. In 1999, the Pool posted its first net loss of \$14.7 million; annual net losses were incurred until 2004. In 2000, the Pool experienced its largest net loss in real terms (\$101.7 million).

The SWP's provincial market share of grain handlings (dotted line in Figure 6.1) reached 67 percent after its 1972 joint takeover of Federal Grain enabled the co-op to have a virtual monopoly at 217 elevator locations (Fairbairn 1984, p. 200). Market share remained relatively stable into the 1990s; for example, in 1992 the Pool's share of provincial grain handlings was 61.2 percent (1992 SWP Annual Report). Market share has fallen significantly since 1999, which is the same timeframe for the Pool's most dramatic decline in net earnings. The Pool's share of provincial grain handlings in 2003 was 33 percent (Schroeder and Chim 2003). In the 2005 SWP Annual Report, provincial market share was stated as 35 percent.



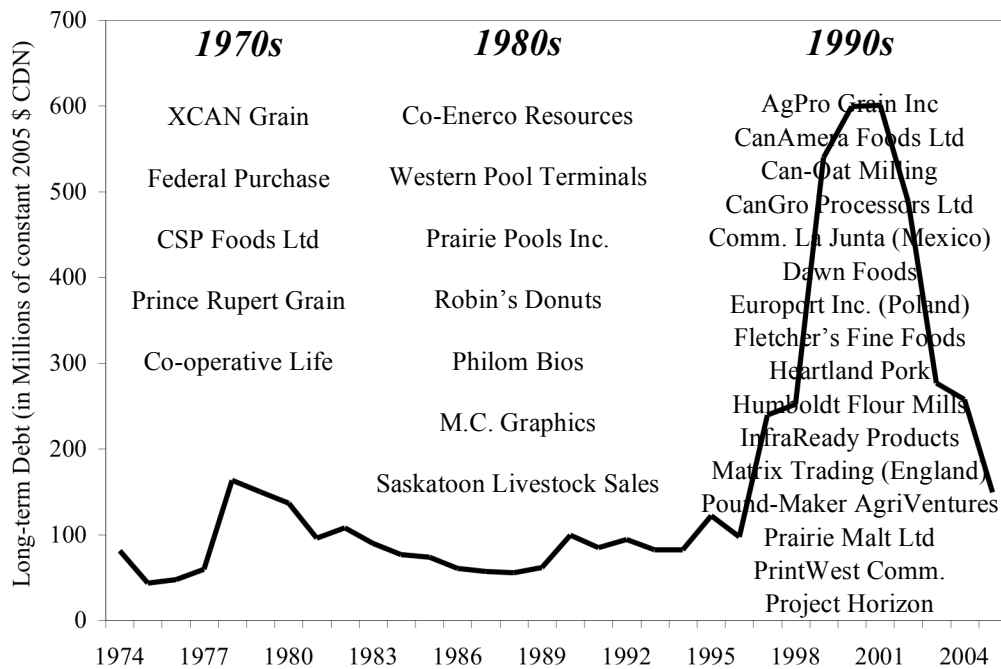
**Figure 6.1. SWP real net earnings (constant 2005 \$ CDN) and provincial market share of grain handlings, 1974-2005.**

Source: SWP Annual Reports *several years*.

Figure 6.2 shows the Pool’s long-term debt (measured in constant 2005 Canadian dollars) from 1974 to 2005 and the majority of capital investments in each of the last three decades. Capital investment in the 1990s was significant, with investments in this decade outnumbering the previous two decades combined. One of the major capital investments in the 1990s was Project Horizon, a \$270 million upgrade and consolidation of the Pool’s grain handling division (1998 SWP Annual Report). The Pool also made its first foreign direct investments in the 1990s, with the purchase of facilities in England, Poland and Mexico (1997 SWP Annual Report).

The solid line in Figure 6.2 is the Pool’s long-term debt from 1974 to 2005. Long-term debt was relatively constant from 1974 to 1996 and never rose above \$161 million.

The numerous acquisitions in the 1990s resulted in a rise in long-term debt from \$96.3 million in 1996 to nearly \$540 million (in real terms) in 1999. A management change in 2000 resulted in the sale of several major business lines, which decreased long-term debt by \$320 million from 2001 to 2003.



**Figure 6.2. SWP long-term debt and acquisitions, 1974–2005.**

Source: SWP Annual Reports *several years*.

### 6.7. 1996 Share Conversion

One reason the Pool was able to take on this debt was its move to become publicly traded on the Toronto Stock Exchange in April 1996 (SWP Investor Relations). The Pool believed that in order to maintain market share and remain competitive in the newly deregulated environment it had to continue diversifying its activities and modernize its grain handling facilities. Nearly half of the Pool's members were set to

retire in the 1990s – and in doing so they would take their retained member equity with them. It was believed that the required investment capital combined with the equity repayment would likely result in a capital shortage (CBC Saskatchewan).<sup>12</sup> The Pool’s solution was to convert the retained member equity to tradable Class B shares, thus providing a much more permanent source of equity (SWP Equity Conversion). The share conversion did not result in additional equity initially, but it did create a more stable source of equity that financial institutions were willing to lend against. Additional capital (\$110 million) was raised through a share offering in 1998.

#### *6.7.1. Prairie Pools Merger Discussions*

Prior to Saskatchewan Wheat Pool making the decision to become a publicly traded co-operative it had had numerous discussions with its sister Pools to devise a plan to become one prairie-wide co-op. The co-ops had proved they could work successfully together; Western Co-op Fertilizers Ltd., Prairie Pools Inc., and XCAN Grain Ltd. were all three-way joint ventures. The last efforts to merge the three Pools were in 1994 with renewed discussions in 1997 and 1999 (Ewins 1997a; WP Saskatoon Newsroom 1999; WP Editorial 2001). The Saskatchewan Wheat Pool was larger than the other two Pools combined. The talks failed because agreement could not be reached on governance issues. Sask Pool officials had made it clear that a merger would be on their grounds; “any new company would be run by SWP executives, would have its head office in Regina, would operate under Sask Pool legislation, would be part of SWP’s stock plan, would use SWP computers and infrastructure, and so on” (Ewins 1997a).

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<sup>12</sup> The SWP anticipated having to pay out more than \$100 million in equity (SWP Equity Conversion 1994).

Saskatchewan Wheat Pool had been researching other ways it could improve its financial structure. On July 14, 1994 Pool delegates voted 110 in favour and 27 opposed to becoming publicly traded entity (Ewins 1994). This vote split was significant because 80 percent in favour was required for an amendment to the Act; 110 out of 137 delegates is 80.3 percent. The SWP stock (SWP.B) began trading on the TSE on April 2, 1996.

#### *6.7.2. Class A and B Shares*

The conversion to a publicly traded co-operative resulted in the creation of two classes of shares: Class A (voting) and Class B (non-voting). The Class B shares were traded on the Toronto Stock Exchange. Only active farmers were eligible to own Class A shares. Prior to full conversion, members had to advise the Pool if they wanted to retain, increase, or sell their shares based on their current equity balance. Each member who chose to convert their equity received one Class A share worth a par value of \$25 and for every \$12 of their remaining equity balance they received one Class B share (Ewins 1996c). Only active farmers could own Class A voting shares, which entitled the member-owner to one vote when electing delegates and the right to participate in Pool Committees (SWP Equity Conversion 1995, p. 8).

The Class B non-voting shares conferred a different set of rights. Class B shareholders were entitled to an annual dividend if the board of directors declared one, an invite to the annual shareholder's meeting, and a vote on issues such as amalgamation, sale of assets, and creation of new share classes. Initially, Class B shareholders were not allowed to own more than 10 percent of the total issued and outstanding shares. This limit was intended to keep majority control of the Pool with the farmer membership. An



amendment in 2002 allowed for “Higher Ownership Limit” to be granted in special circumstances (Bill No. 304 of 2002).

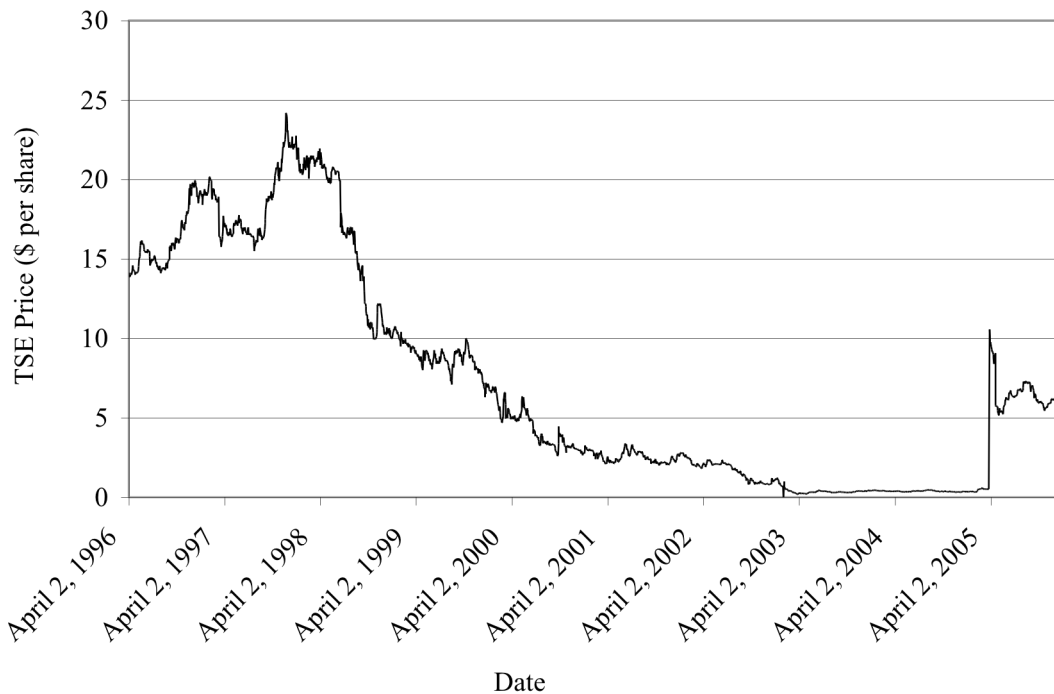
### 6.7.3. *Share Values*

At the start of share trading on the Toronto Stock Exchange Saskatchewan farmer-members owned just over half (53 percent) of the Pool’s capital. There were 29.6 million Class B shares issued; 15.7 million to farmers; 6.4 million to non-Saskatchewan investors; 6.1 million to Saskatchewan investors; and 1.1 million to SWP employees (Briere 1996a).<sup>13</sup>

Shares opened on April 2, 1996 at a value of \$12.00 and rose to a closing price high of \$24.20 on November 21, 1997. From that point forward, share values steadily declined to around \$9.00 in 1999 and then to a low of \$0.18 on March 26, 2003 (see Figure 6.3). For two years – from the beginning of February 2003 until re-evaluation as part of the restructuring to become a federal corporation on March 28, 2005 – Pool shares did not trade above \$0.60. Dividends of \$0.40 per share were paid from 1997 to 1999, but have been withheld since 2000.

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<sup>13</sup> There was a second share offering in 1998 for five million shares at a price of \$20.65 per share (McMillan 1998). In February 1999, \$150 million was raised through a debt offering using five-year notes (McMillan 1999).



Note: The spike in 2005 coincides with the Pool's move to become a federal corporation and the subsequent re-evaluation of stock.

Source: CFMRC TSE

**Figure 6.3. Price of Saskatchewan Wheat Pool shares on TSE, 1996–2005.**

#### 6.7.4. Share Update

In February 2005 the board of directors approved a recapitalization plan to further decrease the Pool's debt. The plan was accepted by Class A and B shareholders and resulted in the consolidation of the two share classes into a single common share with no ownership limit on the shares (Ewins 2005b; Sanford 2005). Class A shareholders were paid the value of their Class A share (\$25). For each Class B share a shareholder owned as of April 22, 2005 they were given the right to purchase one and one third common shares at a value of \$3.21 from April 23 until May 24, 2005 (SWP News Release April 14, 2005). The shares now trade under the stock symbol SWP on the TSE; share price has been between \$7.00 and \$8.00 over most of the past year. The share consolidation

was part of the Pool becoming a federal corporation governed by the *Canadian Business Corporations Act* (Canadian Business Resource 2005). Many industry observers, investors and farmers feel this is the last step before the Pool merges or is acquired by a multinational (Ewins 2005e; 2005f).<sup>14</sup> In fact, on November 28, 2006 the Pool submitted a formal bid to purchase Agricore United, which some industry observers feel is in preparation for the day when the CWB is no longer a monopoly.

## **6.8. SWP Subsidiaries**

Although grain handling and marketing has been the Pool's core business activity, the Pool has diversified over the years. The Pool's divisions once consisted of agri-products, agri-food processing, livestock production and marketing, and publishing. The livestock production and marketing division and the publishing division were fully divested between 2002 and 2004.

### *6.8.1. SWP Subsidiaries*

In its first year of business the Saskatchewan Wheat Pool had a subsidiary, *The Western Producer*, which became the largest weekly farm newspaper in Canada and remained with the Pool until 2002 (SWP Annual Report 1996, 2002). In 1926, the Pool conducted its first solo takeover buying out Saskatchewan Co-operative Elevators and increasing its elevator complement from 89 to 586 facilities by the 1926-27 crop year.

During the 1940s SWP had an "unprecedented surge of commercial expansion and diversification" (Fairbairn 1984, p. 158). In this decade SWP: (1) merged with Saskatchewan Co-operators Livestock Producers Ltd.; (2) opened livestock sales yards in

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<sup>14</sup> On November 7, 2006 the Pool announced its intention to submit a bid to purchase Agricore United. The formal bid was submitted on November 28, 2006. Agricore has until January 24, 2007 to reply to the offer, but has already indicated that the company will formally reject the Pool's hostile takeover bid (Ewins 2006d).

Swift Current, Yorkton, and North Battleford; (3) opened a vegetable oil processing plant; (4) opened a flour mill in Saskatoon; (5) built a two-storey addition and purchased a new printing press for Modern Press, part of its publishing division, and; (6) helped found Co-operative Life insurance which is known today as The Co-operators (Fairbairn p.161; The Co-operators website). The grain handling division was also expanded to 1,162 elevators by the end of the 1940s.

### *6.8.2. 1960s*

In the 1960s, SWP developed a farm service department that eventually became the largest retailer of agricultural chemicals in Canada. In 1965, a joint venture with Alberta Wheat Pool and Federated Co-op saw the creation of Western Co-operative Fertilizers Ltd. which became one of western Canada's largest fertilizer wholesalers (SWP Annual Report 1998). In addition to printing newspapers, SWP also began printing books under its publishing subsidiary Prairie Books. To strengthen its grain handling division, the Pool constructed a port terminal in North Vancouver in 1968; the Pool had already purchased a terminal in Thunder Bay a decade earlier.

### *6.8.3. 1970s*

The growth and diversification continued into the 1970s with the formation of XCAN Grain Pool Ltd, a joint effort between the three Prairie Pools.<sup>15</sup> SWP guaranteed itself a dominant presence in grain handling on the prairies through the 1972 takeover with Alberta Wheat Pool and Manitoba Pool Elevators of Federal Grain Company. At the time Federal was the largest Canadian grain company outside of the pools – and its

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<sup>15</sup> UGG also was involved in XCAN but its share was bought out in 1973-74.

acquisition allowed SWP to capture 67 per cent of the province's grain handlings, this amount tapered to 63 per cent by the end of the decade. Three years later in 1975, SWP's industrial division tripled its crushing capacity twice over through expansion and acquisition and rolled the assets under the subsidiary name CSP Foods Ltd. CSP Foods grew to be one of Canada's largest bakery supply manufacturers and distributors (Fairbairn 1984, p. 208; SWP Annual Report 2000). In its livestock division, the Pool constructed livestock yards and a farm service centre in Regina that was deemed the most modern facility in North America at the time (Fairbairn 1984, p. 208).

It was also during the 1970s that competition started entering the western Canadian grain handling industry. Cargill, Continental Grain Company, and Weyburn Inland Terminal all started vying for the business of the prairie farmer. Word was out that the government wanted to start rationalizing the grain handling system, and SWP knew it had to conform. SWP's elevator complement peaked in 1971 with 1,224 elevators, but closures throughout the decade dropped numbers to 624 by 1982. All the closures had little repercussion on market share, because the Federal Grain Company purchase enabled the Pool to enjoy a monopoly at 217 delivery points (Fairbairn 1984, p. 200).

#### *6.8.4. 1980s*

In the 1980s, SWP initiated its diversification outside the field of agriculture, investing in an oil exploration company named Co-Enerco Resources Ltd. (SWP Annual Report 1982). SWP also took ownership in the inoculant company Philom Bios, created M.C. Graphics, purchased 25 percent Northco Foods (parent company of Robin's Donuts), and 90 percent of E.H. Pope Bakery (SWP Annual Reports 1980-89). In its

livestock division, SWP purchased 65 percent ownership in the Stockman's Exchange Ltd. in Medicine Hat, Alberta and 25 percent of Saskatoon Livestock Sales. In its grain handling division, SWP entered a joint venture with Alberta Pool, Cargill, UGG and Pioneer to have a grain terminal constructed at Prince Rupert, British Columbia in 1982.

The 1980s also saw the formation of Prairie Pools Inc. and the purchase of Western Pool Terminals Ltd. These were joint ventures between the three prairie pools. Prairie Pools Inc. served as a joint lobbying group to provide a unified stance on farm policies.

#### *6.8.5. 1990s*

During the last decade of the 20<sup>th</sup> Century, SWP became Canada's largest publicly traded co-operative and it used its more permanent source of capital to make the decade the most significant in terms of capital investment. SWP had five divisions: 1) grain handling and marketing; 2) agri-products; 3) agri-food processing; 4) livestock marketing, and; 5) publishing and other. Each of these divisions had significant capital investment in the 1990s. Figure 6.2 (page 96) lists the major acquisitions of the 1990s; there were at least twenty expansions and acquisitions made throughout the decade.

The grain handling and marketing division welcomed AgPro Grain Inc. in 1990 which is the name used today by SWP's eight inland terminals located in Manitoba (3) and Alberta (5) (CGC 2006). SWP also had its first foreign direct investment in 1997 under this division through four ventures: 53 percent ownership of Europort Inc. and 10 percent investment in Europort's terminal construction in Gdansk, Poland; 50 percent ownership of Comercializadora La Junta and its terminal construction in Manzanillo,

Mexico; 50 percent ownership of Matrix Trading Company of Newark, England, and; a joint venture with General Mills in Northgate, North Dakota (SWP Annual Report 1997).

The removal of the WGTA in 1995 forced further elevator consolidation, dropping SWP's elevator complement from 553 elevators in 1995 to 385 by the end of the 20<sup>th</sup> century. To reposition itself, the Pool announced Project Horizon in 1997. The Pool initially estimated it would spend \$235 million to simultaneously construct 22 high throughput elevators on mainlines; the elevators would be high throughputs with storage capacities ranging from 25,000 to 45,000 metric tones (CGC 2006). That estimate was increased to \$270 million fifteen months into the project. Five of the high throughputs were slated for locations in Manitoba and Alberta under the SWP subsidiary AgPro Grain Inc. This marked the first time the three Pools would compete head to head.

The agri-products division undertook a joint venture with Mohawk Oil and Pound-Maker AgVentures Ltd. to construct a feedlot and ethanol plant near Lanigan, Saskatchewan (SWP Annual Report 1991). Another joint venture gained SWP ownership in PGE Canada Ltd. a company that processed and marketed borage. The agri-food division saw the bulk of the new acquisitions as SWP attempted to add value to members' crops. For malting barley SWP gained 42.4 percent ownership of Prairie Malt Ltd. and invested \$34 million in 1997 for expansion. For oilseeds CanAmera Foods Ltd. joined the division in 1992. For cereals, legumes and oilseeds investments were made in InfraReady Products Inc. and Bioriginal Food & Science Corporation. By the end of the 1990s, SWP wholly-owned both Can-Oat Milling and Dawn Foods, a food ingredient manufacturer (SWP Annual Report 1996; 1998).

In the livestock production and marketing division, the Heartland trio – Livestock Services, Pork Management, and Feed Mills – came under ownership of SWP. There was even discussions to build up to eight 10,000 to 20,000 head capacity feedlots (SWP Annual Report 1998). CanGro Processors Ltd. and its aquaculture business joined SWP in 1997. Forty-five per cent ownership of Fletcher’s Fine Foods (Premium Brands as of 2000), western Canada’s largest pork processor at the time, was obtained in the 1997-98 crop year (SWP Annual Report 1997-98; 2000). In the publishing division, SWP invested in PrintWest Communications in 1992.

#### 6.8.6. 21<sup>st</sup> Century

In 2000, there was a turnover of both the Board Chairman and the Chief Executive Officer.<sup>16</sup> Other than a few agreements for marketing with Toepfer International or financing programs with Farm Credit Canada, SWP spent the first four years of the century divesting from unprofitable business ventures. In 2000, SWP sold its foreign interests in Matrix Trading (England) and Europort Inc. (Poland), its 35 percent ownership of Robin’s Foods, and its Agro Pacific Industries Ltd. In 2001, SWP divested from XCAN Grain Pool Ltd., Heartland Livestock Services, and Premium Brands. In 2002, divestiture from Western Pool Terminals Ltd., Western Co-operative Fertilizers Ltd., CSP Foods Ltd., CanAmera Foods Ltd., Heartland Feed Mills, and *The Western Producer* occurred. In 2004, SWP divested from Heartland Pork Management, CanGro Aquaculture, and Comercializadora La Junta (Mexico). Since 2000, SWP has closed 334 elevators and 88 “under-performing retail stores”, it has divested or exited from 29

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<sup>16</sup> Marvin Wiens replaced Leroy Larsen as Board Chairman; Mayo Schmidt replaced Don Loewen as CEO. From June 1999 until January 2000, Bill Hunt was the Pool’s interim CEO. Schmidt was an Executive Vice President with KBC Trading and Processing Co. in Stockton, California before joining the Pool (SWP Annual Report 2000, p. 2). KBC Trading and Processing is a ConAgra subsidiary.



businesses, and it has reduced its labour force by over 50 percent in an attempt “to restore to the Pool to a position of strength” (SWP Annual Report 2005, p. 4).<sup>17</sup>

## **6.9. Summary**

The Pool has been a key player in the western Canadian grain handling industry for over 80 years. Created by producers, the Pool worked hard to obtain the best prices for producers’ grain. SWP also worked hard for producers’ needs – lobbying for policies and regulations concerning agriculture issues and beyond. The Pool served its members well thus enabling it to capture a large portion of the market share.

The Pool’s strength and member loyalty was built in a highly regulated grain handling industry. Many of the acts and regulations governing rail transportation, grain inspection, and grain marketing were established before the Pool began operations in 1924. It was in the 1970s that the regulations began to be challenged. The railways were pressuring for change to the Crow Rate because their costs were not being covered. Federal Agriculture Minister Otto Lang was on the railways’ side, believing that the statutory freight rates were a hindrance to producers and railways. Strong lobbying by the Pool held off dissolution of statutory freight rates, but the WGTA was one step closer to full deregulation. When the WGTA was introduced in 1983 the Pool was in its heydays; its highest net earnings occurred in 1981 and its provincial market share was over 60 percent.

Change had been occurring over the decades but heavy lobbying by farm groups and the Pools created and maintained government involvement in the grain handling industry. The 1990s was a decade of immense change –removal of the WGTA,

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<sup>17</sup> See Appendix D for details on some of the Pool’s investments and divestments.

restructuring of the CWB, branch line abandonment, new grain handling competitors and grain car tendering were all part of the industry change. A once highly regulated industry underwent drastic revision and the grain companies needed to react.

In 1996, one year after the removal of the WGTA, the Pool became publicly traded and collapsed its dual-head structure. There was a concerted effort to build the commercial side of the Pool and the lending power created from the share conversion allowed that growth to occur. The Pool began broadening its diversification plans by investing in projects throughout Canada and internationally; \$270 million was spent on Project Horizon to upgrade the Pool's grain handling system to large concrete inland terminals (SWP Annual Report 1998).

The market and financial indicators show that the Pool's response to industry change did not work. Net losses began in the 1998-99 crop year, the Pool's 75<sup>th</sup> year of operation, and persisted for the next six crop years; market share fell from 61% to 35% in ten years (1993 to 2003), and share values dropped from a high of \$24.20 per share in November 1997 to a close of \$8.60 per share on July 31, 1999 (SWP Annual Report 1999). The decline in share price was during a time when the Pool was investing heavily in new grain handling capacity. The Board did terminate the CEO and Executive Vice-President of the Grain Group in the 1998-99 crop year, but no plans were made to scale back Project Horizon as the debt to equity ratio reached 50:50. Net losses continued, market share decreased further, and in early 2003 the Pool was forced into a \$405 million debt restructuring plan and divestment from major assets.

There are many postulations and explanations as to what went wrong at the Pool. The Pool was not the only grain company having to deal with the industry changes. An

appropriate way to shed some light on this question is to ask those who were directly involved – the management and board members of the Pool and industry affiliates. Chapter 2 laid out two propositions as to what may be the underpinnings of the Pool's financial failure. Chapters 5 and 6 have discussed historical events surrounding the western Canadian grain handling industry and the Pool. Chapter 7 will now put some context to those historical events by presenting interview responses in a case study forma

## CHAPTER 7: CASE STUDY RESULTS

### 7.1. Introduction

In this chapter responses from twenty-one of the personal interviews conducted with past SWP management, elected personnel and industry affiliates are presented and analyzed in a case study format. Quotes from interviews are referenced to transcript numbers. Each interviewee has been given two random transcript numbers to preserve their anonymity. Interview quotes are attributed to unnamed individuals; a board member(s), a senior manager(s) or a number of interviewees. Whenever possible, published material that supports interviewee statements is included to strengthen the argument.

The interviews clearly indicated that board members, senior management and management of the Pool were aware of the changes occurring in the industry and that they believed they were taking steps to deal with these changes. Interviewees revealed that the Pool had a strategy to remain the dominant player in the new grain handling industry and to expand internationally. Management and board members felt this strategy could only be achieved if the Pool acted quickly. There was a change in the culture and the Pool became more commercially oriented, yet many believed that the member loyalty established in the 1970s and 1980s remained. As stated in the 1997 SWP Annual Report, one of the “keys to our success is a special relationship with our farmer-members who have a long and intimate association with the Pool” (p. 35). Analysis and decision-making reflected the need for speed and led to investments that lacked adequate analysis and due diligence. The Pool’s lens on the emerging industry contained elements

of an “old” dominant logic and key decision-makers held inaccurate beliefs. The new dominant logic and the retention of some outdated beliefs resulted in the Pool’s financial difficulties and 2003 debt restructuring.

Interviewee comments about the board-management relationship suggest that the principal-agent problem played a role in the Pool’s financial difficulties. The tenures of CEOs Ira Mumford and Milt Fair had built trust between board members and senior management, a trust that remained in place when Don Loewen was appointed CEO. Loewen had 22 years experience with the Pool and his past efforts and ambitions were seen as necessary to attaining the Pool’s new strategy. Board member inexperience and an increasing reliance on management for explanation gave management the power to manipulate and mislead. The share conversion increased the need for confidentiality and served as a starting point for information asymmetry. Board members believed information was not being shared with the entire board and that investments were being made without the board’s knowledge. While other investment decisions that seemed plausible later emerged as poor decisions according to some board members. The board of directors is the final check and balance for the co-op; if they trust senior management and do not know how to properly evaluate investment proposals, there is potential for a principal-agent problem.

In this chapter, the elements of the Pool’s dominant logic are analyzed. Examples of the beliefs, culture and decision-making processes, and their interaction with each other, are presented. The Pool used its dominant logic to establish the strategies for competing in the new grain handling industry. In conjunction with the dominant logic is the principal-agent problem. If board members have less information than management,

then the knowledge and understanding of board members is negatively affected. Board members can have inaccuracies in their knowledge if management intentionally keeps information from board members, which allows inaccurate knowledge structures to be sustained. A shift in power and lack of understanding by the board worked to ensure management could aggressively pursue its growth strategy. Investments made by the Pool during the 1990s can be linked to an “old” dominant logic, erroneous cognitive processes and to the principal-agent problem.

## **7.2. Drastic Change – Recognition and Response**

The interviewees were asked to comment on the challenges that they recalled the grain handling industry facing during the period 1980–2000. All interviewees recognized the drastic changes occurring in the grain handling sector – deregulation, removal of the Crow rate, rail line abandonment, elevator consolidation, and changing farmer needs. The removal of the WGTA on August 1, 1995, meant wheat was no longer king. The Crow rate removal basically made the Pool’s “traditional wooden elevators obsolete”.<sup>18</sup> The “industry had not radically changed its infrastructure for a long time”.<sup>19</sup> A board member believed “the rail lines and the system was going to become highly consolidated. It would be a highly centralized system and very competitive, leaving vast areas with no service”.<sup>20</sup> Crop mixes changed; “farmers were growing eight or ten crops rather than two or three, the bulk handling system that is for wheat or durum or barley was not as important as it had been. We saw a lot of specialty plants for pulse crops that did not use

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<sup>18</sup> Transcript 14.

<sup>19</sup> Transcript 15.

<sup>20</sup> Transcript 11.

the traditional grain handling system.”<sup>21</sup> One interviewee stated there was a time when 80 percent of Pool handlings’ were Board grains.<sup>22</sup> <sup>23</sup> “There was a feeling that the Pool had to start looking at positioning itself commercially in a different way. One of those ways was to further increase its investment in the value-added industries.”<sup>24</sup>

A senior manager recalled that “as all the regulations fell away from the grain side they simply had no choice but to become much more market-driven and market influenced”.<sup>25</sup> A board member similarly recalled how a “decision had to be made as to how far and how fast we would go to redesign country elevators”.<sup>26</sup> All interviewees noted that the Pool needed to “diversify and value-add”. This strategy was so important that board members and management believed the Pool would not survive if it did not diversify.<sup>27</sup> The Pool would draw on its established beliefs and views to make investment decisions to successfully complete this strategy.

The changes in the industry had to be faced by all existing grain companies. All the grain handling co-operatives, due to their lack of permanent equity, had to find alternative ways to raise the capital that would be required to adapt. The other three co-ops developed capital plans similar to the Pool’s. United Grain Growers became publicly traded in 1993 and within three years it had invested \$123 million in new plants that would allow it to capture freight rate incentives from loading unit trains (Ewins 1996a). Three additional share offerings (in 1993, 1994 and 1996) raised \$56 million so UGG could continue to modernize and invest in new infrastructure (WP Staff 1996). Agricore -

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<sup>21</sup> Transcript 30.

<sup>22</sup> Transcript 17.

<sup>23</sup> In 2005, 60 percent of the grains handled by the Pool were CWB grains; in all fairness, that same year 76 percent of WIT’s handle was CWB grains (WIT Annual Report 2005, p. 17).

<sup>24</sup> Transcript 21.

<sup>25</sup> Transcript 27.

<sup>26</sup> Transcript 35.

<sup>27</sup> Transcripts 7, 18, 4, and 17.

formed by the 1998 merger of AWP and MPE – had a capital expenditure budget of \$200 million in the 1998-99 crop year (Ewins 1998). Agricore CEO Gordon Cummings was quoted as saying, “We would like to be the leading organization both in farm inputs and in the grain handling business” (Ewins 1998).

### **7.3. The Pool’s Dominant Logic**

Recall that an organization’s dominant logic is an assembly of beliefs, views, strategies and culture (Section 3.2.5 on page 28). The dominant logic filters information and is the lens through which an organization views the world (Bettis and Prahalad 1995). Stable environments, such as the heavily regulated grain industry, can cause elements of a dominant logic to become engrained. The 1970s and 1980s was a very successful time period for the Pool; the highest earnings in the Pool’s history were achieved in 1981. When a major industry change occurs, an organization will need to create a new dominant logic. Key decision-makers will provide many of the new beliefs and views. Despite attempts to adapt, an organization has a tendency to hold on to established beliefs and views from past successes when developing the new logic.

In response to the grain industry’s major wave of deregulation, rail line rationalization and elevator consolidation in the early 1990s, the Pool used established beliefs of market dominance and member loyalty to determine its role in the new grain handling industry and agribusiness world. These two beliefs, along with new beliefs of urgency and a need for culture change, were incorporated into a new dominant logic. A change in the Pool’s culture allowed the beliefs of senior management to infiltrate the beliefs of the co-op and the board members. Although the Pool built a new logic, it



contained components from its old dominant logic interspersed with new beliefs that were not ideal for the co-op.

### *7.3.1. Dominance Belief*

The Pool believed it would continue to play a major role in western Canadian grain handling – this was an established belief. With strategies to expand nationally and internationally, the Pool extended its dominance belief to include all future investments. The Pool “handled a majority of Saskatchewan’s grain in 1998. Our long-term goal is to build on this dominant position in profitable market segments” (SWP Annual Report 1998, p. 12). Beliefs of dominance and urgency complement each other because in order for the Pool to view quick expansion as the optimal strategy it needed to also believe all investments would be successful.

A senior manager pinpointed the Federal Grain purchase as the start of the Pool’s dominance.<sup>28</sup> The 1972 acquisition of Federal Grain boosted the co-op’s provincial grain handling market share over 60 percent. As one board member stated, the Pool’s size and the success of some of the previous things the Pool had done influenced the risks and investments the Pool took on.<sup>29</sup> “Its size did lead it on to taking bigger risks and with bigger risks can come bigger opportunities.”<sup>30</sup> The Pool’s size and volumes gave it the opportunity to do things that other companies in the Canadian market were unable to do. Several of the interviewees used similar wording to describe the Pool’s dominance: it was the “biggest kid on the block”, the “big boy on the block”, and the “big guy on the

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<sup>28</sup> Transcript 13.

<sup>29</sup> Transcript 14.

<sup>30</sup> Transcript 3.

block”.<sup>31</sup> Interviewees recalled how Pool management and board members truly believed the Pool could become “the ConAgra of the North”.<sup>32</sup> There was a belief that the Pool would be “one of the four or five top grain companies in the world” and would grow its revenues from “four to forty billion in ten years”.<sup>33</sup> One senior manager, however, felt this belief of dominance was not corporate-wide and was only held by some individuals.<sup>34</sup>

A sense of confidence permeated the board members and management, as Loewen stated, the Pool has “seen the changes coming better than a lot of companies” (Casey 1997). The Pool believed it was “well positioned for the changes rapidly transforming the once highly regulated and stable industry” and had “taken and will continue to take a lead role in defining the future of this industry” (1997 SWP Annual Report, p. 14, 35). Past board member Dave Sefton was certain that the Pool would become the “most dynamic cooperative business in the world” and would eventually have membership from agricultural producers around the world (Gatin 1999, p. 83).

Other grain industry participants expressed confidence in the Pool as well, which served to validate management and board members’ belief of market dominance. Scott Schroeder of Dominion Bond Rating Service (DBRS) said the industry changes would “leave few survivors. Saskatchewan Wheat Pool and Cargill will be the only ones—it’s a pretty safe bet” (Casey 1997). In 1996, Schroeder also commented that the Pool was “a powerhouse that could become another ConAgra” (Briere 1996b). In 1998, at the Fourth Agricultural and Food Policy Systems Information Workshop, Barb Isman, Cargill’s Assistant Vice President of Corporate Affairs, stated that to gauge the “future of the

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<sup>31</sup> Transcripts 10, 17, 11, and 8, respectively.

<sup>32</sup> Transcripts 18 and 32.

<sup>33</sup> Transcripts 7 and 39, respectively.

<sup>34</sup> Transcript 17.

western agricultural industry...policy analysts might use their time and resources most wisely if they simply talked to three companies: SWP, Cargill and...Monsanto” (p. 149).

In November 1996, an analyst with RBC Dominion Securities estimated Pool stock would climb 20 percent over the next year and be worth \$21.00 per share (Ewins 1996d). Pool share prices rose as high as \$24.20 in late 1997, indicating the Pool had the support of the investment community. One board member commented how “analysts were identifying that SWP [shares] should be worth \$32.00” so the Board felt confident in the decisions and strategies being pursued.<sup>35</sup> The share price provided a false sense of security and reaffirmed Pool beliefs.

### 7.3.2. *Loyalty Belief*

A belief of dominance required a belief of long-standing loyalty from the Pool membership. Continued member loyalty was built into the projections and analysis of Pool investments. Gaining and maintaining market share was necessary to achieve the Pool’s newly established belief of market dominance and to ensure the plethora of newly acquired investments were successful.

The Pool was known as “the policy organization in the country” and its lobbying efforts invoked strong member loyalty.<sup>36</sup> “People would go 20 miles out of their way, in the early 1980s, to do business with the wheat Pool.”<sup>37</sup> Provincial market share was over 60 percent for 20 years, which aided in the establishment of the loyalty belief among some in management and the board.

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<sup>35</sup> Transcript 4.

<sup>36</sup> Transcript 19.

<sup>37</sup> Transcript 12.

The Pool's political clout was evident during the Crow rate debate of the 1980s. Before the federal government went ahead with any rate reform they wanted "to win some measure of support from the [Pool]"; they did not want to "face the outright opposition of the Prairie's largest grain company and farm lobby group" (Wilson 1980).

The high throughput elevators being built under Project Horizon would require a sizeable market share. The mindset was "build them and they'll have to come because they just won't go anywhere else and they'll only support the Pool".<sup>38</sup> This mindset was part of the loyalty belief. According to one board member, in the past when elevators closed farmers would initially say they would never deliver another bushel to the Pool, but "after about two or three years they started coming back to Saskatchewan Wheat Pool... We thought that would happen with Project Horizon".<sup>39</sup>

Interviewees had differing opinions on market share. While some interviewees strongly believed market share should not be relied upon in projections, others believed that market share would not only hold but also grow. As long as the decision-makers holding power in the Pool believed that market share would grow, the belief of loyalty would prevail. The Pool believed it was an agricultural co-op in which "the interests of the company and its producers are aligned in pursuit of better ways to do business and new opportunities to create wealth for our shareholders" (SWP Annual Report 1997, p. 35). Market indicators clearly showed that market share and net income were declining, yet assumptions explicitly included that membership would remain with the organization. This suggests cognitive dissonance was at play; managers and board members ignored information that market share was falling because it conflicted with their beliefs that their

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<sup>38</sup> Transcript 26.

<sup>39</sup> Transcript 36.

membership was loyal. For discussion on the Pool's declining member commitment, see Lang and Fulton (2004).

It troubled one manager that member loyalty was seen as "cast in concrete".<sup>40</sup> The Pool failed to realize "that you can never take your customers or your members for granted because you will not survive".<sup>41</sup> Another management interviewee said the Pool "committed a fundamental error in choosing to believe the membership would stick with them, yet they were doing everything in my opinion to distance themselves from the membership".<sup>42</sup> According to one senior manager "as you saw the ConAgra's and Louis Dreyfuses and all the producer terminals springing up, market share was inevitably going to decline since it just could not be maintained with all the other new entrants".<sup>43</sup>

The Pool's market share declined steadily after 1992. Some interviewees attributed the decline to a new generation of farmers who are the "now" generation that want instant gratification on the elevator ramp.<sup>44</sup> While others felt the Pool "alienated" its members and did not do a good enough job of engaging people on the impending change and what it meant for their relationship with the Pool.<sup>45</sup>

### 7.3.3. *Urgency Belief*

A new belief of urgency had the Pool spending money without hesitation. From 1996 to 1999, the Pool invested in approximately twenty-five acquisitions and long-term debt grew five-fold (SWP Annual Reports). The need for urgency, at times, outranked the need for adequate analysis.

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<sup>40</sup> Transcript 10.

<sup>41</sup> Transcript 26.

<sup>42</sup> Transcript 18.

<sup>43</sup> Transcript 13.

<sup>44</sup> Transcripts 3 and 11.

<sup>45</sup> Transcripts 19 and 22.

The need for the Pool to react quickly to industry change was expressed by nine of the interviewees. The Pool believed it needed to “move rapidly in order to beat the US competition” and it needed to become more of a global player and expand beyond Saskatchewan borders.<sup>46</sup> There was a driving belief that if the Pool did not “stay at a significant size to be a competitor; you will become one of two things: irrelevant or sucked up”.<sup>47</sup>

A June 1997 *Canadian Business* article quoted CEO Don Loewen as saying “if we don’t become a strong, global force, we will just be eaten up by the American [multinationals]. Quite frankly, they’ll eat our lunch.” This statement strongly suggests the Pool was confident in its strategies. The Pool’s mission statement became “Growing global, growing together”. As one management personnel stated, “there was this pressure to do things quickly and preemptively before someone else does it”.<sup>48</sup>

The 1996 share conversion provided access to debt capital for quick expansion. As one interviewee described it, the Pool felt like it had a bottomless pit of money and “if someone was willing to give them a nickel they would take it. Simply because they thought they had to move that fast”.<sup>49</sup> The knowledge structures of some of the key decision-makers included a belief that fast paced growth was the correct strategy. With the “larger amounts of capital from the public markets, not only could they make a lot of decisions quickly, they felt they were expected to make a lot of decisions quickly”.<sup>50</sup>

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<sup>46</sup> Transcripts 9 and 36, respectively.

<sup>47</sup> Transcript 1.

<sup>48</sup> Transcript 27.

<sup>49</sup> Transcript 34.

<sup>50</sup> Transcript 15.

#### 7.3.4. *Culture*

Culture drives the vision of an organization and is reflected through attitudes, behaviours, and decision-making processes. The culture of an organization affects the working relationship between the board and management. Culture is dependent on the power balance between the board and management; as Pool management gained power the culture was increasingly influenced by management's objectives.

For several years the “culture of the organization was farmer oriented” and “member interests were on the forefront of every decision”.<sup>51</sup> When Loewen became CEO in 1994, there was a distinct change in culture.<sup>52</sup> “One could almost describe the change in corporate culture as 180 degrees”.<sup>53</sup> There was a desire to fundamentally transform the organization. One board member said “there were things about the corporate culture that people felt needed to be changed”.<sup>54</sup> There was a concern that decisions were made on “Pool time” instead of “real time” and the democratic process made decision-making far too slow.<sup>55</sup>

Loewen was seen as the right individual for the job of CEO. “Don came up through the flourmill and CSP Foods and did a very commendable job in running that side of the business. When he was under the control of Milt Fair, Don was an excellent person.”<sup>56</sup> Investments orchestrated by Loewen – Robin's Donuts and CSP Foods – had turned out well for the Pool so the board “didn't think he could do anything wrong”.<sup>57</sup> One board member explained how Loewen was hired because “he was that type of

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<sup>51</sup> Transcripts 20 and 11, respectively.

<sup>52</sup> Transcript 14.

<sup>53</sup> Transcripts 19.

<sup>54</sup> Transcript 30.

<sup>55</sup> Transcripts 30 and 4.

<sup>56</sup> Transcript 25.

<sup>57</sup> Transcript 34.

individual who moved fast” and the board was told to “keep the reigns on this individual because he will be very aggressive and so the Pool board will have to be the balance”.<sup>58</sup> Loewen was “commercially ambitious which the Board welcomed because we were still looking at expanding our value-added and downstream activities”.<sup>59</sup> The accelerated acquisitions during the 1990s were part of the mandate that Loewen had with the Board when he came in. “For better or worse, that is what they were looking for and that is the direction he led them”.<sup>60</sup>

Loewen had a main role in changing the culture. He was described by interviewees as “aggressive”, “venturesome” and “gifted at visualizing opportunities”.<sup>61</sup> In a 1997 interview, Hugh Wagner of the Grain Services Union described Loewen as “extremely purposeful and forceful...he has done more in the past 3 years to change the Pool than many others have in a lifetime” (Gatin 1999, p. 94). He was “absolutely driven by the thought that they had to move very, very quickly that the organization would either be the biggest grain handling company in western Canada and be part of the North American scene within five years or they would be broke”.<sup>62</sup> He had everybody “hooked on this idea of being the biggest and the best and a forty billion dollar company.”<sup>63</sup> Loewen “brought in people in the senior posts of like mind”; there was an entire “new senior group with the exception of the CFO”.<sup>64</sup> In replacing management, Loewen was said to be removing some of the “old true guard”.<sup>65</sup>

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<sup>58</sup> Transcript 14.

<sup>59</sup> Transcript 35.

<sup>60</sup> Transcript 17.

<sup>61</sup> Transcripts 21, 11 and 2, respectively.

<sup>62</sup> Transcript 7.

<sup>63</sup> Transcript 10.

<sup>64</sup> Transcripts 9 and 27, respectively.

<sup>65</sup> Transcript 34.



In 1996, the dual head structure of the Pool was collapsed and Loewen became the sole management head. For many years the Pool operated with a Corporate Secretary and Chief Executive Officer – each reported to the board on their respective divisions. The Corporate Secretary was responsible for the Policy and Membership Services Division and the Chief Executive Officer was responsible for the Commercial Division. There had always been tension between the two heads.<sup>66</sup> Part of the reason for removing the Corporate Secretary was to make the governance structure more typical of corporations and more attractive to investors. With Loewen as the single head for the commercial and policy sides of the Pool, his power increased and as one interviewee stated, “the organization has never been the same”.<sup>67</sup>

One board member described the Pool as feeling “invincible and that was driven by Don Loewen’s personality and a number of people around him that just felt we couldn’t be stopped”.<sup>68</sup> Loewen’s strong leadership was “going to drive this home”; “the CEO’s job is to stop internal dissent, stop those in the company who were not consistent with the vision and the direction that the CEO was trying to drive”.<sup>69</sup> Loewen’s power and leadership style was reflected in the investment decision-making; an interviewee described decision-making as “shoot from the hip” with gut feelings, at times, determining investment decisions.<sup>70</sup>

Some interviewees criticized the change in culture. What may have started as a “culture of vision” became a “culture of denial”.<sup>71</sup> Another management employee used

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<sup>66</sup> Transcripts 4 and 20.

<sup>67</sup> Transcript 42.

<sup>68</sup> Transcript 30.

<sup>69</sup> Transcript 15.

<sup>70</sup> Transcript 7.

<sup>71</sup> Transcript 32.

the words “naïveté and arrogance” to describe the corporate culture.<sup>72</sup> These descriptors stemmed from the opinion that “people were put into very senior operational positions having no outside experience, either outside the Pool or outside a very introverted part of the grain industry in downtown Winnipeg”.<sup>73</sup> The Pool was considered to be missing the experience and background on its board to say, “No, this doesn’t make sense” instead “they are going to believe the people they think should know rather than having that experience themselves”.<sup>74</sup>

A culture driven by a powerful CEO and like-minded senior managers went a long way to changing the direction of the Pool. Loewen was appointed CEO for his ability to initiate change and he did just that. The culture and beliefs instilled by Loewen and other like-minded senior managers strongly influenced the analysis and decision-making at the Pool.

### 7.3.5. *Analysis and Decision-Making*

As one interviewee plainly stated, “proposals and business plans were based on assumptions, in the end those assumptions have to take reality...[or] you are going to learn a very hard lesson”.<sup>75</sup> There was “a definite deterioration in the quality of analysis” post-conversion.<sup>76</sup> Some analysis was described as “suspect” because “logic was not always necessarily the basis for what was being done in business acquisitions”.<sup>77</sup> Interviewees revealed a pressure “where you didn’t rock the boat if you wanted to get to the top or close to the top” and “if you did not go along with the flow then you were

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<sup>72</sup> Transcript 9.

<sup>73</sup> Transcript 9.

<sup>74</sup> Transcript 31.

<sup>75</sup> Transcript 19.

<sup>76</sup> Transcript 14.

<sup>77</sup> Transcript 12.

ostracized or you were replaced”.<sup>78</sup> One interviewee felt that “staff does not feel comfortable going back and doing honest analysis. Staff is more likely to feel like it is their job to go out and prove it is not that bad of a decision or it is an okay decision.”<sup>79</sup> This links back to Mintzberg (1971) (see Section 3.3.3. on page 35); employees may choose to remain mum when they are in disagreement with management’s views rather than face losing their job. Another interviewee’s understanding of the analysis was that there was good analysis being done, but if certain senior managers did not like the analysis coming forward they would ask for the analysis to be changed.<sup>80</sup>

Interviewee responses regarding the Pool’s attention to due diligence were varied. More than one interviewee believed that better due diligence could have been done.<sup>81</sup> Risk-analysis and proper evaluation of the downside of investments was not always done.<sup>82</sup> The need to move quickly and expand resulted in project analysis being altered to rationalize investments. However, this point was contradicted by other board members and senior managers who said “the usual financial due diligence” was being done and investments were “all based on projections of an appropriate return on investment”.<sup>83</sup>

Nevertheless, the need to move quickly to diversify and value-add affected the analysis and the decision-making process. “Ideas did not get what I would regard as proper and adequate evaluation, if Loewen wanted to do it everyone would find a way to make it happen”.<sup>84</sup> One board member explained how “the argument that was being

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<sup>78</sup> Transcript 18 and 34, respectively.

<sup>79</sup> Transcript 32.

<sup>80</sup> Transcript 22.

<sup>81</sup> Transcripts 7, 19, 38, 15 and 9.

<sup>82</sup> Transcript 15.

<sup>83</sup> Transcripts 17 and 1.

<sup>84</sup> Transcript 39.

made was that if we did it first, no matter what we paid for it, we would prevent our competition from doing it and then we would be successful”.<sup>85</sup>

The Pool’s dominant logic included beliefs from its past – member loyalty and market dominance – incorporated into new strategies and a new culture. Moving quickly, even if that meant inadequate analysis, was senior management’s strategy to drive change and to become one of the top grain companies in the world. Loewen’s charisma and power allowed him to shift the Pool to a market-driven, commercially-oriented organization. To achieve this goal, senior management did require board approval. Senior management was able to use established trust and an increased information imbalance to move the Pool toward the vision of “ConAgra of the North”. An abuse of trust and the presence of information asymmetry give rise to the principal-agent problem.

#### **7.4. Principal-Agent Problem**

The principal-agent problem occurs when an agent (management) uses information asymmetry and the principal’s (board) reliance on management to take advantage of the situation and achieve their own objectives. As an organization grows it becomes increasingly more difficult to monitor management’s actions. Board members are removed from the day-to-day activities of an organization resulting in information asymmetry between principal and agent. If the information asymmetry is grouped with board inexperience, an inability to monitor management and an implied trust in management, the principal-agent problem can emerge.

Milt Fair was the Pool’s CEO from 1981 until 1993. Fair orchestrated acquisitions, such as the purchase of Elders Grain and the Northern Sales terminal, which

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<sup>85</sup> Transcript 30.

solidified the Pool's market share dominance. Milt's ability to make successful investments led the board to trust management's insight. The board "trusted the management and they had grown to trust management from Milt's days because he would not lead them astray" even if this meant introducing ideas to the board three or four times.<sup>86</sup> Milt "did not push his weight around, he was respected in the business community,...and I think that is what brought on a lot of dedication".<sup>87</sup> When Milt Fair was CEO he "worked effectively with the President and the Board of Directors".<sup>88</sup> "CEO Milt Fair had the total responsibility for operations, but management was always available for discussions with board members".<sup>89</sup>

There was trust in Loewen too. As one board member stated, the "Board and the CEOs were very much in tune with each other's needs and desires and there was a good deal of trust – a lot of trust".<sup>90</sup> Some in management felt that Loewen "had the confidence of the board of directors and so there was really no impediments in his path".<sup>91</sup> The 1990s was full of change for the Pool; culture changed, the Pool became publicly traded, and senior management changed, but the trust did not change.

Becoming publicly traded changed the board-management relationship. The "need for confidentiality increased when [the Pool] went to a share offering".<sup>92</sup> The Pool had to become less specific about where it had business interests because of corporate governance and the risk of insider trading.<sup>93</sup> This was a starting point for increased information asymmetry. The risk of insider trading became a valid reason for not

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<sup>86</sup> Transcript 7.

<sup>87</sup> Transcript 4.

<sup>88</sup> Transcript 12.

<sup>89</sup> Transcript 2.

<sup>90</sup> Transcript 36.

<sup>91</sup> Transcript 18.

<sup>92</sup> Transcript 2.

<sup>93</sup> Transcript 11.

adequately sharing information. Loewen was said to have threatened that a leak would lead to dismissal.<sup>94</sup> As one board member saw it “there were a lot of things shared with the President that never got adequately shared with the rest of the Board. Getting things done became more important than sharing information”.<sup>95</sup> In contrast, one senior manager said, “the amount of information we supplied was information overload at times” and “it was more that the board did not know the questions to ask”.<sup>96</sup>

“The Board of Directors did not have the makeup or the people on it that would normally have served that check and balance to senior management, that would occur in a company somewhere else”.<sup>97</sup> Part of this was because “increased board appointments by acclamation affected the types and quality of people that were getting put forward as board members”.<sup>98</sup> As one senior manager commented, the Board seemed to be missing the “cynical eye on the thing that you really need”.<sup>99</sup> An individual who “wasn’t afraid to ask you the simple hard questions”; it would “force you to think it through and come better prepared” with proposals.<sup>100</sup> At the same time, the move to a publicly traded company was “a quantum shift” and “as the business got more sophisticated, and more complicated, and moved further away from the farm gate it got tougher” for board members to assess proposals.<sup>101</sup> The volume of proposals and expected promptness for decisions to be made “would have been difficult even for a competent Board to stay abreast and do a fair job of assessing what was coming in”.<sup>102</sup>

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<sup>94</sup> Transcript 26.

<sup>95</sup> Transcript 40.

<sup>96</sup> Transcript 13 and 37.

<sup>97</sup> Transcript 31.

<sup>98</sup> Transcript 12.

<sup>99</sup> Transcript 17.

<sup>100</sup> Transcript 17.

<sup>101</sup> Transcripts 21 and 27, respectively.

<sup>102</sup> Transcript 9.

There was no legal expertise, marketing expertise or financial expertise on the board so management had to be the expertise for the Board.<sup>103</sup> “The board of directors is there to be guidance, experience and wisdom.”<sup>104</sup> As the Pool expanded, it became increasingly difficult for board members to provide that expertise.<sup>105</sup> The board members “could ask far more informed questions about whether or not to build grain elevators” than about international grain terminals.<sup>106</sup> A board member admitted that “as we got more external, we had to rely more and more on our CEO and CFO and others to provide us with the types of insights and analysis we needed to make decisions...”<sup>107</sup> Other interviewees were also well aware of this dependence on management by board members and the board’s inability to challenge the CEOs assumptions.<sup>108</sup>

An increased reliance on senior management likely started with the share conversion discussions in 1994. Past board member Gary Wellbrock was interviewed for Gatin's (1999) Master’s thesis on the Pool’s share conversion. In his interview Wellbrock “explained that the SWP directors were not accountants so they needed in-depth sessions with executive management in order to understand the financial issues involved with working capital and debt equity ratios” (p. 74).

Some senior managers said “there wasn’t the person [on the Board] who would do the homework” because for board members it was “stepping way beyond your comfort zone” and “when it came to managing an entity that was worth close to a billion dollars in assets they were a little out of their league”.<sup>109</sup> Others felt the board “wouldn’t have

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<sup>103</sup> Transcript 8 and 23.

<sup>104</sup> Transcript 6.

<sup>105</sup> Transcript 6.

<sup>106</sup> Transcript 27.

<sup>107</sup> Transcript 11.

<sup>108</sup> Transcripts 10,18,19,21,3 and 9.

<sup>109</sup> Transcripts 13,8 and 38, respectively.

received full analysis”.<sup>110</sup> In hindsight, one board member feels the board “has to accept some very heavy responsibility for not having tighter control over management and investment”.<sup>111</sup> Board members feel they are ultimately responsible, as another board member admitted that they “didn’t understand the impact that change was going to have on the whole operation”.<sup>112</sup>

A lack of control over management indicates a shift in power. With Loewen as CEO and Larsen as President there was “the quickest transformation of power from a President’s office to a CEO’s office...”<sup>113</sup> As senior management gained power from the board they were able to coerce and manipulate the board.<sup>114</sup> The board’s reliance on management for explanation on investments and the information asymmetry created by the share conversion and expanding breadth of investments aided in this transfer of power. This shift closely aligns with comments made in Gatin’s (1999) thesis on the Pool’s share conversion. Grain Services Union General Secretary, Hugh Wagner, noticed a shift in power occurring and described it as “management was running astray with the company” (p. 90).

It could be argued that the share conversion further divided the goals of co-op members and management. Previously, farmer members would receive a share of the Pool’s profits based on their patronage but after the share conversion that incentive no longer existed. The co-op exists in the first place to serve the needs of its members. Since management could not be seen as favoring farmer interests over B shareholder interests, so there was a trend towards farmers’ interests not being met. Management would want

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<sup>110</sup> Transcript 32.

<sup>111</sup> Transcript 35.

<sup>112</sup> Transcript 4.

<sup>113</sup> Transcript 22.

<sup>114</sup> Transcripts 18 and 9.



to side with B shareholders, because they were also shareholders in the co-op.<sup>115</sup>

Another perk to the share conversion was the increase in senior management salaries.

Prior to the share conversion CEO Don Loewen was earning an estimated \$244,571 and at the time of his resignation he was earning \$423,684 (Ewins 1995; Briere 1999).

## **7.5. Investments**

The dominant logic and principal-agent problem are evident in the investments undertaken by the Pool. The belief of urgency resulted in twenty-five new or expanded investments between 1996 and 1999. Beliefs of dominance had the Pool investing outside Saskatchewan and in the international arena where it had no previous experience, while a belief of loyalty had the Pool building new concrete terminals based on the expectation that market share would remain constant. There were international investments the board was not fully aware of which suggests that a principal-agent problem was at play. The information asymmetry, lack of understanding and trust in management by board members allowed investments that did not make economic sense.

There were three investments that were mentioned during nearly every interview. The 1997-1998 investments in international – Poland, Mexico, and England – and western Canadian – Project Horizon – grain handling were commented on extensively. The 1998 investment in Humboldt Flour Mills often served as an example of a Pool decision-making error. Interviewees provided insight into the assumptions and decision-making processes behind these investments.

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<sup>115</sup> Over 50 percent of the Pool's employees bought a total of 1.1 million shares under the initial share offering (Ewins 1996b).

### 7.5.1. *Project Horizon*

SWP's Project Horizon – an elevator transition plan announced in 1997 – was first estimated to cost \$235 million and was expanded to \$270 million in 1998. Project Horizon announced all of its locations and began building all twenty-two high throughput elevators simultaneously. This was described as a “bold stroke” by industry analysts (SWP Annual Report 1997, p. 5). Several interviewees described constructing the elevators all at once as an attempt to lock up the contractors before others could build.<sup>116</sup> The Pool “firmly believed they were going to stop the competition literally by tying up all the construction capacity for these high throughput elevators in the short-run”.<sup>117</sup> Project Horizon was based on a “first-mover advantage” wherein the Pool “firmly believed they were going to stop the competition from investing because they had already invested”, but SWP “didn't understand the second, third and fourth moves in the competitive dance that goes on in a competitive industry”.<sup>118</sup>

This “move quickly” approach did not work. Board members expressed their astonishment that companies would build facilities just a few miles down the road from a SWP high throughput location.<sup>119</sup> To one board member the response by industry to build in a market that was overbuilt was illogical”.<sup>120</sup> The competition response negatively affected the Pool's revenue projections from grain handling as the Pool had “explicitly included in their assumptions that their producers would go to their high throughput elevators”.<sup>121</sup>

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<sup>116</sup> Transcripts 7, 38 and 14.

<sup>117</sup> Transcript 15.

<sup>118</sup> Transcript 15.

<sup>119</sup> Transcript 36.

<sup>120</sup> Transcript 24.

<sup>121</sup> Transcript 32.

In July 1998, Loewen was interviewed on the Pool's decision to speed up the Project Horizon construction. In this *Western Producer* interview, he was quoted as saying "Our goals are to be the low-cost grain handler in western Canada and to grow our existing market share from 31 to 40 percent" (WP Saskatoon Newsroom 1998). This statement shows that the Pool not only believed it would maintain its western Canadian market share, but also expand it.

Interviewees questioned the Pool's choice to build with concrete; "Did it have to be concrete? Was concrete a good choice when competitors were able to build a facility for half the price with steel?"<sup>122</sup> Steel elevator construction was being utilized by ConAgra and Louis Dreyfus. The locations for the SWP elevators "were picked very quickly. We had a team out in the country going before it was announced, very quickly finding property and buying property and sewing up the property so no one else could".<sup>123</sup> Looking back "a number of those locations were not well thought out or well researched", but the "argument was made to do it in a hurry, let's make it large, let's tie up all the contractors and nobody else will build and we will have a large part of the market sewn up. Wrong answer, because the competitors just went ahead and...built lower cost facilities that were more cost competitive."<sup>124</sup>

Project Horizon included the belief of urgency and market dominance. These beliefs proved to be inaccurate as competitors still constructed inland terminals in close proximity to the Pool's high throughput elevators. A case in point would be Davidson, Saskatchewan where a Pool and UGG elevator were built on opposite ends of the town.

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<sup>122</sup> Transcript 32.

<sup>123</sup> Transcript 30.

<sup>124</sup> Transcript 30.

Locations not being well researched are evidence that analysis and decision-making was flawed.

### 7.5.2. *International Investments*

In 1997 the Pool made investments in handling terminals in Poland and Mexico. In 1998 the Pool invested in Matrix Trading – a grain marketing firm – in England. One board member is severely critical of two investments; “those would be the two terminals that were built in Poland and Mexico. I think whether it was bad analysis or it was a lack of insight into the changing environment, I guess not fully appreciating the strategic influences in those respective countries and unstable environments.”<sup>125</sup> A SWP News Release stated unforeseen changes with the rail transportation system in Mexico as a reason for the Manzanillo terminal becoming an obsolete distribution point. Some interviewees lay partial blame on “unscrupulous partners” and consulting company data that “did not come to fruition”.<sup>126</sup> There were interviewees who partly blame the Pool because these were areas where the Pool had no traditional operating knowledge.<sup>127</sup> Neither board members nor senior managers had any experience in international investments. Problems with investment partners and consulting companies show a lack of due diligence and inexperience in the international business arena.

Both board members and managers disclosed information about “farming operations” and a “farm supply division in Russia and Ukraine”.<sup>128</sup> Details were lacking, but one senior manager described the investment as “a project where they were going to farm a large farm in the Ukraine. That was very short lived. There wasn’t much

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<sup>125</sup> Transcript 11.

<sup>126</sup> Transcripts 1 and 13, respectively.

<sup>127</sup> Transcripts 15 and 9.

<sup>128</sup> Transcripts 34, 14, 30, 15, and 23.

involvement there in the end of the day. Nothing happened that I can recall. There was a farming operation and some combine purchases.”<sup>129</sup> Two interviewees believe combines were sent over from Canada and as one interviewee stated, “it was a multi-million dollar disaster to get those combines over there and get them working and I don’t know where they are today”.<sup>130</sup> These investments in the Ukraine are not public knowledge and did not appear to be common knowledge among interviewees. As one interviewee said “I don’t even know what happened in the Ukraine”.<sup>131</sup>

The 1997 SWP Annual Report does make mention of marketing and agrifood opportunities in Eastern Europe and the former Soviet Republics because the agriculture practices were similar to the Prairies. However, the annual reports never make mention of farming operations in Europe. In reference to these investments one board member stated, “the board wasn’t aware of some of that and consequently when we did find out it was too late”.<sup>132</sup>

### 7.5.3. *Humboldt Flour Mills*

Even though Humboldt Flour Mills was not the Pool’s largest investment it was the investment that began to raise questions about how much the Pool was spending.<sup>133</sup> The acquisition of Humboldt Flour Mills in 1998 was described by one senior manager as “a bidding war with Agricore”.<sup>134</sup> Rivalry between the two Pools stemmed partly from Saskatchewan’s decision to build a few of its Project Horizon high throughput elevators in Manitoba and Alberta, which meant it would be in direct competition with its sister

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<sup>129</sup> Transcript 23.

<sup>130</sup> Transcripts 34 and 30.

<sup>131</sup> Transcript 15.

<sup>132</sup> Transcript 14.

<sup>133</sup> Transcript 19.

<sup>134</sup> Transcript 13.

Pools. Alberta Wheat Pool President, Alex Graham, was “miffed about Sask Pool’s plan to grab 25% of the Alberta market” and was quoted as saying “That’s the Saskatchewan attitude. It will dominate. It will run over anyone that’s in the way” (Casey 1997). Moving into Manitoba and Alberta was part of the Pool’s repositioning in order to solidify its dominance in western Canadian grain handling.

When Alberta Wheat Pool and Manitoba Pool Elevators expressed interest in Humboldt Flour Mills, the Pool “didn’t want the Alberta Wheat Pool in farm supplies in innermost Saskatchewan” so the Pool “ended up paying \$16 million for Humboldt Flour Mills”.<sup>135</sup> The Pool “had not done their homework” on this investment, as “a number of sprayers, physical assets, trucks, fertilizer equipment...turned out be rental units” and not part of the purchase.<sup>136</sup> The purchase of Humboldt Flour Mills was an attempt to “keep Agricore out” even if that meant paying “far more for Humboldt Flour Mills than what made economic sense”.<sup>137</sup> The March 1998 offer from Alberta and Manitoba Pools was 85 cents per share; SWP’s offer was \$1.20 per share (McMillan 1998b). This purchase “was the bellwether that told everybody else in rural Saskatchewan that they were out of control”.<sup>138</sup>

## **7.6. Summary and Discussion**

The case study evidence presented here in Chapter 7 validates the two propositions introduced at the end of Chapter 2. *Proposition 1* stated that the Pool’s dominant logic prevented effective adaptation to industry change and significantly contributed to its financial failures. Senior management’s goal to become a globally

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<sup>135</sup> Transcripts 34 and 12.

<sup>136</sup> Transcripts 7 and 10.

<sup>137</sup> Transcript 30.

<sup>138</sup> Transcript 34.

recognized agri-business co-operative was unsuccessful. Elements of the Pool's old dominant logic still existed as the industry changed. The Pool was blind to what to expect in the new grain handling industry that was unfolding. In reconstructing the dominant logic for the new environment, the Pool retained some of its established beliefs which were no longer accurate. Relying on outdated views and beliefs within the organization led the Pool to adopt unsuccessful strategies in response to the deregulation of the 1990s that resulted in organizational failure.

*Proposition 2* stated that the principal-agent problem existed between Pool senior management and the board members. Information asymmetry and the inability of board members to fully monitor senior management, allowed senior management to gain approval on investment proposals that should have been rejected by the board. The board had grown to trust senior management, which increased the incidence for the principal-agent problem.

The interview responses strongly suggest the Pool's revised dominant logic contained outdated beliefs that characterized the basis for success achieved in previous years. The Pool also relied on the knowledge structures of key decision-makers to construct a new logic; some of the new beliefs were not accurate as well. Interviewees recognized the grain-handling industry was undergoing massive change and new strategies were devised to remain competitive. Senior managers forced their beliefs on the organization; strategies to move quickly and gain a global presence were part of the belief structure among some of the senior managers. There was a strategy to move quickly and diversify in order to remain at the forefront of the grain-handling and agri-business scenes. There was a belief that the Pool would be just as successful as the large

multinationals that were entering western Canada (e.g., ConAgra, Louis Dreyfus, Bunge, and ADM). A natural result of pattern making, the Pool's successes during the 1970s and 1980s had established beliefs and views that the Pool's future would resemble its past. The dominance and market share built and maintained over previous decades was seen as sustainable. Like all grain companies, the Pool was unable to know for certain what the new rules of competition would be and how the industry would evolve under a deregulated structure. In essence, the Pool used beliefs and views from its old dominant logic in conjunction with newly established beliefs from senior management to devise strategies for the new grain-handling environment. Project Horizon was built on the assumption that farmers whose local Pool elevator closed would shift their deliveries to the closest Pool inland terminal. This investment reflects a belief of member loyalty, which was established prior to industry change and should have been revised because of the deregulation.

The Pool strongly believed it was prepared for the emerging grain-handling environment. The Pool's size and past successes were seen as continued certainties because they were part of the dominant logic that controlled how the Pool viewed its role during and after the changes. Senior managers convinced board members that speed was necessary to succeed. Moving quickly became a competitive strategy and the Pool's lens on the environment said that was the correct move. This was in fact an ineffective strategy as the need to move quickly resulted in some investments lacking adequate analysis and due diligence. The analysis may have been jeopardized because employees did not want to "rock the boat" by raising dissent. Three international investments were announced in 1997 even though interviewees felt management and board members



lacked previous experience in the international arena. Having experience was trumped by the belief that the Pool was dominant, it was the big kid on the block, and it would make any new venture succeed.

The interviewee responses strongly suggest the principal-agent problem existed at the Pool. Senior management had more information than board members and were thought to discriminate on who was apprised of arising business opportunities. As the Pool expanded and diversified the board was called to make decisions on investments that extended way beyond their comfort zone (e.g., grain handling on the Prairies). The speed with which the Pool was expanding increased the information asymmetry. After the share conversion board members felt that information sharing decreased and often the President learned things that were not shared with the rest of the board. Outside advisors may have helped the board members in making decisions; unfortunately they were added in 2000 after all the investments had been made and the debt loads were becoming unmanageable.

Board members were thought to be lacking the expertise and skills necessary to evaluate proposals, which adds to the information asymmetry and opportunity for moral hazard. Senior management was often asked to provide guidance and explanation on proposals, perhaps allowing them to more easily gain approval on investments. Board members had an increasingly difficult time analyzing investments as they moved further away from the farm gate. The speed with which the investments were coming to the board for approval also challenged the board's abilities. But because the board believed the Pool needed to move quickly to succeed, approvals were granted that should have

been rethought or rejected. The board held the belief of urgency because senior management had enforced it and board members trusted management's perceptions.

Senior management took advantage of the board's trust. The board had grown to trust management under the leadership of Milt Fair. This element of trust enabled senior management's beliefs to become the board's beliefs and part of the co-op's dominant logic. Don Loewen was seen as trustworthy, which is why he was selected to take the Pool successfully through industry change. The balance of power, along with the balance of information, shifted from President to CEO post-share conversion. Senior management appears to have used the vulnerabilities of the board members to push through their vision for the Pool.

Although the impact of a flawed dominant logic, inaccurate knowledge structures among key decision-makers and the principal-agent problem have been discussed separately they are highly connected. It was the simultaneous existence of these three elements that led to the Pool's financial failure. The ramifications of the principal-agent problem reinforced the inaccuracies of the newly revised dominant logic. The board members served as the final check and balance on the Pool's decisions. To adequately analyze an investment the board members drew from their established knowledge and beliefs. Whenever board members were uncertain about a proposal their knowledge gaps would be filled by senior management. The information provided by the senior management could be distorted or screened because of the information asymmetry, the board's inability to fully monitor management and management's desire to see the Pool gain global status. Board members incorporate senior management's advice and explanation into their own belief structures. This in turn becomes part of the Pool's

dominant logic with little debate because board members trust senior management to not lead them astray. Inaccurate information further distorts any already faulty beliefs and views held in the dominant logic. With the investments being made quickly and simultaneously – three international investments and the Project Horizon all within 1997 – it took some time before the investment errors began to surface. By the time negative financial repercussions were being experienced it was too late and the Pool had a financial crisis to deal with.

The experience of the Pool is not unlike the experiences of the American agricultural co-ops discussed in Chapter 2. Supporting historical recounts of the Pool's response to industry change with interview responses from previous board members and management has shown that the deregulation in the 1980s and the move to become publicly traded in the 1990s was a starting point for the Pool's problems. The Pool held market dominance prior to the major industry changes. Debt leveraging was used to diversify the Pool's business lines in the 1990s. Declining member commitment harmed grain handling market share and played a role in the Pool's eventual financial failure. Diversifying business lines in response to major industry change combined with high leveraging, declining member commitment and market dominance were also common elements among the failed American agricultural co-ops introduced in Chapter 2. Chapter 8 will further describe the linkages between these co-ops and the Pool.

## CHAPTER 8: CONCLUSIONS AND RECOMMENDATIONS

### 8.1. Introduction

The case study evidence presented in Chapter 7 has established how the Pool viewed the grain handling environment and how that view affected the decisions made by the Pool. The Pool knew it had to change its strategies, which required a new dominant logic to be built. A new CEO was handpicked by the Board to create change, therefore, senior management's views held precedence in the new logic that emerged. The case study evidence suggests key decision-makers – Loewen and his new senior executive – forged a new logic but they also held onto established beliefs of loyalty and dominance because these beliefs would help senior management achieve their vision for the Pool. With the grain handling industry changing so drastically, established beliefs should have been challenged and re-evaluated before being incorporated into the new logic. Management, however, was successful in having board members buy in to the new vision set out for the Pool. This may be partly due to what interviewees described as a shift in power that occurred after the share conversion and it might be because the board members trusted management to not lead them astray. Likely with all of the grain handling co-ops undergoing the same pressures and undertaking similar efforts to rebuild their infrastructures, the Pool felt confident that the right game plan was in place.

The discussion has come full circle. In Chapter 2, existing research on failed American co-ops – TriValley Growers, Rice Grower's Association, and AgWay – was shared and propositions to explain the Pool's failure were outlined. The events surrounding the Pool's failure were presented in Chapter 6. Case study evidence in Chapter 7 linked the failure to the propositions from Chapter 2. Cognitive processes and

the principal-agent problem have been shown as plausible explanations for the Pool's organizational failure. The next section will show the parallels between the events preceding the Pool's debt restructuring and the events leading up to the failures of the three American co-ops. The existence of similarities between the cases makes it reasonable to assume that the failures of the American co-ops may also be attributed to cognition theory and the existence of a flawed dominant logic and the principal-agent problem.

## **8.2. Common factors among large failed co-ops**

In determining the linkages that exist between the Pool and the three failed American co-ops discussed Table 2.1 (page 12) has been expanded to contrast and compare the four co-ops. Table 8.1 is merely an expansion of Table 2.1 to include SWP. The following sub-sections describe, in greater detail, the similarities between the four co-ops.

### *8.2.1. Dominance and member loyalty*

Dominance and member loyalty are to be considered "established" beliefs that each of the co-ops retained despite industry change and no assurance that the new environment would resemble the past. All four co-ops achieved market dominance in their respective sectors. A belief of dominance led to a belief of continued success, and in some instances greater success, and made the co-ops confident to expand through diversification. Tri Valley Growers was the largest canner and fruit processor in California in the late 1990s. During the 1970s and 1980s, RGA's members accounted for over 70 percent of the California rice acreage.

There are striking similarities between AgWay and SWP. Both AgWay and the Pool established their dominance in the 1970s and 1980s. Agway's dominant logic included a belief that it could make any business work even when others could not. This parallels the Pool's belief that it could become a "ConAgra of the North" and a real contender with the multinationals. AgWay was also described as focusing too much on size rather than maximizing profit. The Pool also focused on size with its vision to become the most dynamic agri-business co-operative in the world.

Member loyalty went hand-in-hand with the co-ops' ability to gain market dominance. Unfortunately, each of these co-ops experienced a decline in member loyalty. RGA's decline stemmed from its decision to send its members bills instead of dividends in 1985; the result was a 94 percent decrease in membership from 1986 to 2000. AgWay lost membership due to aging members and increasing farm size. AgWay also had a membership backlash when it closed its local stores. Similarly, producer backlash from the Pool's closure of local elevators in the 1990s declined its provincial grain handling market share. When the Pool increased its elevator closures some members vowed to never do business with the Pool again.

**Table 8.1. Common factors among four co-op failures.**

	<b>Tri Valley Growers<sup>a</sup></b>	<b>Rice Growers Association<sup>b</sup></b>	<b>AgWay<sup>c,d</sup></b>	<b>Saskatchewan Wheat Pool<sup>e,f</sup></b>
<b>Industry Change</b>	Change in production areas; increased demand for pasta, salsa and bbq sauces; new processing technology	Declining government support; Domestic branded rice expected to grow; bulk export markets declined	Change in market conditions; Increased concentration in farming; Decline in pelleted feed demand	WGTA removal; rail line closures; elevator consolidation; new entrants; liberalized trading rules
<b>Dominance</b>	California's largest canner in 1998; largest fruit processor in California	Controlled +70% of Californian rice acreage during 1970s and 1980s	Largest ag supply and marketing co-op in US during 1970s and 1980s	Largest grain handler in Western Canada during 1970s and 1980s
<b>Unsuccessful Strategies</b>	Purchased failed co-ops; Missed bulk paste market; underutilized plants; raised prices which declined sales	Involved in too many product lines; entered highly competitive value-added rice market; Koreagate	Diversified where it had no previous experience; Belief that it could make any business work; Focus on size	Went too far too fast; invested internationally without experience; Move quickly; incomplete due diligence; overbid on HFM
<b>Member Loyalty</b>	Fruit producers upset that profits used to subsidize losing tomato division; tomato growers not loyal	Producers sent bills in 1985; Membership decreased 94% in 14 years from 2500 to 150 members	Loss of 23,000 members over 12 years; Lost connection with members when it closed stores	Lang and Fulton (2004) identify member loyalty decline; closing elevators alienated members
<b>Diversified</b>	Olives; Peaches; Pears; Tomatoes; 154 peeled products; 22 sauces; 61 pastes	Only major California producer of short, medium and long grain rice; bulk and retail markets	Retail/Grocery; Energy; Food Preservation; Futures Trading; Dairy; Seed; Leasing; Airlines; Refining	Grain handling; Livestock production and marketing; Farm Supplies; publishing; Milling; Aquaculture; malting; oil crushing
<b>Board Decision-Making</b>	"Blinded to economic realities"; Lacked strong business orientation and control over management	Lack of oversight, education and financial expertise; failed to supervise management; ill-equipped to scrutinize mgt	2001 changed election process to gain "business-oriented" directors with "sound business skills"	Lacked experience in law, finance, and marketing; Relied on management for guidance; Advisors added in 2000
<b>Management Decision-Making</b>	CEO made radical cost-cutting measures; Executives lacked food processing experience	Ineffective management; Did not fully evaluate decisions; remiss in planning for future contingencies	Selected and poorly executed wrong strategies	Lacked depth; Undertook investments outside area of expertise; "management running astray" <sup>g</sup>
<b>Financial Trouble</b>	High debt-to-equity ratio prevented necessary facility upgrades; long-term debt quadrupled; overpaid growers in 1998	Net profit declined 94% from 1981 to 1990; 12 D-E Ratio in 1989; missed payroll in 2000; unpaid debt lawsuits	Highly leveraged; Selling successful businesses to generate cash flow; Losses 8 out of 19 years, 1984–2002	5x increase in long-term debt 1996-1999; Consecutive multi-million dollar net losses 1999 to 2003; major divestment after 1999
<b>Failure</b>	Filed Ch. 11 in July 2000	Bankrupt in 2000	Filed Ch. 11 October 1, 2002	Restructured debt January 2003

Source: <sup>a</sup> Sexton and Hariyoga 2004; <sup>b</sup> Keeling 2004; <sup>c</sup> Fairbairn 2003b; <sup>d</sup> Anderson and Henehan 2002; <sup>e,f</sup> SWP Annual Reports; Ewins 2002; <sup>g</sup> Gatin 1999; Lang and Fulton 2004

### 8.2.2. *Unsuccessful Strategies*

Each co-op had their cognitive capacities tested when their respective industries underwent major change. Strategies by each of the co-ops that later proved unsuccessful suggests that the co-ops did not accurately perceive how their industries would unfold in response to major change. For instance, AgWay invested in a fluid dairy company, a business where it had no previous experience. SWP also invested in businesses where it had no previous experience – in 1997 the Pool invested in three international investments when no one in management or on the board had international experience. RGA changed its focus in 1987 to value-added products when its entire knowledgebase and experience was in bulk rice marketing.

The co-ops all pursued efforts to diversify their business lines in the hopes of increasing their profit potential and spreading their risk. Yet at times the co-ops held onto money losing investments. Did the diversification limit the co-ops' ability to provide the attention required for each of its business lines, therefore causing some to fail? Was cognitive dissonance preventing key decision-makers from seeing the true reasons behind the business troubles and instead leading decision-makers to attribute poor financial performance to circumstances beyond their control?

TVG nearly made the decision to jettison its tomato processing division rather than continue to cross subsidize it with fruit division profits, but opted not to and it was this division that caused the most financial hardship for the co-op. AgWay continually focused on being an agriculture-based co-operative, but its agriculture operations were money losers in the 1990s (Fairbairn 2003b, p. 15). Grain handling was expected to



become less profitable, but the Pool invested \$270 million to rebuild its elevator network because grain was a staple ingredient for its downstream investments.

When the Pool began its capital expenditures in the 1990s, interviewees commented how there was a “diversify or die” mentality. RGA was under the same belief; in 1988 CEO Mike Cook said RGA must “diversify or declare bankruptcy” (Keeling 2004, p. 15). AgWay had a new “focus on growth and profitability” (Anderson and Henehan 2002, p. 7). All four co-ops had been dominant players in their core industries and it was part of their belief structure and dominant logic that this dominance would remain if only they diversified.

Each co-op attempted strategies that did not yield desirable outcomes. TVG attempted to penetrate the peeled and branded products market in the 1990s, but this strategy put TVG in direct competition with large, financially strong rivals (Sexton and Hariyoga 2004, p. 22). RGA similarly tried to change its focus from bulk rice marketing to value-added, but by targeting the small differentiated market RGA neglected the bulk market. AgWay was venturing into business lines where they had not previously operated and they ended up selling those investments due to mounting financial losses (Anderson and Henehan 2002, p. 3). SWP made aggressive investments in pork under the subsidiary Heartland Pork. The Pool announced its intention to build twenty-five barns worth \$12 million each; local investment was said to be a requirement before proceeding with barn construction (1997 SWP Annual Report). The desired level of local investment never materialized, but the Pool went ahead and built seven barns without the proper financial footing (Pratt 1999). The barns were all sold for a reported \$22.4 million to Stomp Farms in May 2004 because of financial troubles (Briere 2004).

### 8.2.3. *Relationships and competition*

Both RGA and the Pool had co-op “siblings”. Co-op siblings were similar co-ops with which RGA and the Pool had an amicable business relationships. When these relationships ended for each co-op the sibling co-ops became rivals. RGA had developed a “big brother, little brother” relationship with Farmer’s Rice Co-operative (FRC). In the early 1980s these co-ops had a falling out over Koreagate and their jointly shared broker Grover Connell. Even though they were involved in several successful joint ventures and shared contracts, from that point on the strategies of the two co-operatives diverged and FRC gained a commanding share of the bulk rice market (Keeling 2004, p. 19). The relationship between RGA and FRC is not unlike the relationship between the sister Pools. The sister Pools operated many successful joint ventures – XCAN, WCFL, Prairie Pools – and made a number of merger attempts. The Pools parted ways after their last merger discussions in the mid to late 1990s; SWP built elevators in Alberta and Manitoba and outbid AWP on Humboldt Flour Mills in order to keep AWP out of Saskatchewan. SWP now directly competes with Agricore United (formerly AWP, MPE and UGG) much like how RGA had to directly compete with FRC.<sup>139</sup>

### 8.2.4. *Financial troubles*

The reality faced by many co-ops is that there is limited access to capital due to obligations to payout patronage equity when members retire or cancel membership. When a co-op wants to respond to industry change they may need to find new ways to finance their diversification strategies. The Pool became publicly traded in 1996 to increase its eligibility for debt capital. RGA was looking to dissolve the co-op and

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<sup>139</sup> On November 28, 2006 the Pool submitted a formal offer to purchase Agricore United (Ewins 2006d).

restructure as a for-profit company in 2000. TVG converted to a new generation co-op in 1996. AgWay had common and preferred shares for its capital base. Changing to a more permanent source of capital allows for greater ease when obtaining debt capital. It could be argued that if money is easier to obtain then it becomes easier to spend.

All four co-ops had high debt-to-equity ratios. This is an indicator that they had taken on too much debt. TVG quadrupled its long-term debt in one year, while SWP had a five-fold increase in long-term debt over three years. The debt load became unmanageable and net losses were incurred. SWP had consecutive multi-million dollar net losses from 1999 to 2003. In the period 1975-1988 RGA's debt-equity ratio increased significantly which Keeling (2004) points out as the co-op taking on "relatively large amounts of debt without commensurately increasing their equity base" (p. 26).

Subsequently, RGA began having lawsuits filed against them in 1989 for unpaid debts which forced divestments. AgWay reported losses in 8 out of 19 years during the period 1984-2002; net earnings of \$41 million were declared in 1998, but only \$5.9 million were from continuing operations (Fairbairn 2003b, p. 12). By 2002, AgWay's earnings had slipped to a net loss of \$98 million of which \$85 million was from closing costs associated with the sale of discontinued operations. To generate cashflow AgWay sold its profitable sunflower business and its profitable leasing subsidiary (Anderson and Henehan 2002). The Pool was in a similar situation; between 1999 and 2004 the Pool sold over 20 of its investments including Humboldt Flour Mills, Heartland Pork and its three international investments. All five of these investments were acquired after the 1996 share conversion. The Pool also sold WCFL, *The Western Producer*, and CanAmera which were successful business ventures for the co-op. The Pool's debt-to-

equity ratio was 39:61 in 1994, which is the year Loewen became CEO. By 2000, the ratio was 60:40, the exact opposite of what is normally considered a healthy debt-to-equity score (40:60).

#### *8.2.5. Board and management decision-making*

All four co-ops were large, centralized marketing or supply co-ops and their core business was in the agriculture industry. With farmers as members, these co-ops all had a farmer-elected board of directors. It has been suggested that the board makeup within each of these co-ops lacked business savvy. The Pool's board members were described as lacking financial and marketing expertise. Interviewees described how Pool board members became increasingly dependent on management to provide expertise and advice, especially as investments moved beyond primary agriculture. RGA's and TVG's board members were also described as lacking strong business orientation and financial expertise. One of the conclusions drawn from the survey conducted on former RGA affiliates was that the "board of directors failed to actively exercise its duty to supervise management" (Keeling 2004, p. 2). In addition, RGA was slow to follow FRC's lead when FRC implemented board education, added financial experts to sit on the board, and had younger members join the board. AgWay added outside advisors to the board makeup in 2001. Though never publicly admitted by AgWay, some thought this governance change was an attempt to gain directors with sound business skills. Outside advisors were also added to the Pool's board in 2003 as a requirement of its debt restructuring agreement.

The managers at the four co-ops were held equally responsible for the financial failures. Management is criticized for their role in the decision-making process in each of

these co-ops. TVG's CEO is criticized for his radical cost cutting measures, such as firing all the experienced plant supervisors. RGA's management was described as ineffective and unable to guide the co-op through tough times. AgWay management was said to have selected and poorly executed wrong strategies (Fairbairn 2003b, p. 11). The Pool management has been described as lacking depth and experience.

Interestingly, many of the new strategies and investments that preceded each of the financial failures for these four co-ops were orchestrated under the direction of a new CEO. Shaping a new dominant logic under a new CEO would bring in new experience and knowledge, which is key for the co-op in its rebuilding phase. As interviewees shared about the Pool, Loewen was hired in 1994 because the board felt confident that he could drive change. It is also possible that the other co-ops hired new CEOs because they wanted to change or expand the direction of their co-op. TVG hired Famalette in 1995 and in 2000 the co-op filed for bankruptcy protection. AgWay hired Cardarelli in 1995; he specifically mentioned that the co-op's new focus would be growth and profit and in 2002 AgWay filed for bankruptcy protection. RGA hired CEO Mike Cook in 1987 and that same year RGA shifted its focus from bulk to value-added rice marketing.

Numerous similarities between these four co-ops strongly suggest the American co-ops likely had problems revising their dominant logics when faced with drastic industry change. The decision-making errors on the part of management and board members suggest that information asymmetry and principal-agent problem were at play. There are other failed co-ops within Canada that need to be researched to see if they too were struggling with deeply rooted beliefs, dominant logic inaccuracies and the principal-agent problem.

### **8.3. Recommendations and lessons learned**

There are lessons to be learned from the failure of the Pool and the American co-ops. Agriculture is still undergoing major change and the playing field will continue to evolve and alter the rules of competition. Currently, the federal government wants to rescind the *Canadian Wheat Board Act*, which would once again change the grain handling industry. Corporate governance has become important for all businesses. Agriculture co-ops must be mindful of their board structure and to ensure that members have the support and continuing education programs to assist them in their fiduciary responsibilities. Many co-ops have changed their board make up to include public members to serve as impartial industry experts. For the producer-members of the board there should be courses in finance and management provided to ensure an understanding of the decisions they are making. A board with strong knowledge and business skills will help to alleviate the risk of information asymmetry and moral hazard.

Thorough research analysis and complete due diligence must be part of every investment decision. Keeling (2004) suggests that co-ops at a critical juncture conduct a SWOT – strength, weakness, opportunity, and threat – analysis to “give decision-makers a clearer perspective of the cooperative’s internal and external environment and aid in strategic planning” (p. 33). The saying “drastic times call for drastic measures” is an anecdote and not a rule for an organization to operate under. Interviewees expressed that at times the Pool forewent adequate discussion and debate on potential investments because speed was seen as more important. A case in point is the Pool’s high throughput locations; Hodgeville is often given as an example of a high throughput location that was not well thought out because the Pool was in a hurry to get a jump-start on the

competition. Experience among managers and board members is key to deciphering strategies for success in a changing environment.

The future is uncertain. Bounded rationality clearly states that it is impossible to know all there is to know and what is known cannot be known with complete accuracy. When an organization has developed dominance and achieved prolonged success within a market it is natural for the organization to rely on established beliefs to make decisions for present and future situations. The risk is that the organization can become blind to the realities going on around it and opportunities on the horizon. Beliefs may become outdated because times have changed and a new dominant logic with new beliefs is required. A balanced and experienced management team and board of directors will significantly help in decreasing the chances of missed opportunities and ineffective strategies. New leadership brings new knowledge and experience, but there needs to be a balance to ensure that the new beliefs are also not inaccurate.

#### **8.4. Limitations and Recommendations for Further Research**

Cognition and dominant logic, along with the principal agent problem, are ways to explain what went wrong at the Pool. The interview responses support the two propositions introduced in Chapter 2. *Proposition 1* was that the Pool's dominant logic prevented effective adaptation to industry change and significantly contributed to its financial failures. *Proposition 2* was that the principal-agent problem existed between Pool senior management and the board members.

There are several ways to explain the failure at the Pool. One should not overlook the role of declining member commitment or the difficulties associated with being a co-operative in the Pool's struggles. The need to focus the thesis puts limits on the breadth

of the discussion. Cognitive dissonance is another useful way to approach this problem. Recall from Section 3.2.6 (page 31) that established beliefs could cause an individual to ignore information that conflicts with their beliefs (Akerlof and Dickens 1982). As the level of difficulty increases in decision-making, the belief that a decision is a good decision also increases; making it harder to accept information that suggests the decision is incorrect (Akerlof and Dickens 1982, p. 310). It could be argued that the Pool's decisions involved great effort - the Pool was undergoing a quantum shift in its business focus - which led management and board members to ignore information signals that showed strategies required modification.

Using personal interviews helped to reveal insights that supported what many had already postulated. An effort was made to conduct interviews that would capture a wide range of views from senior management, management and board members and industry players. This was achieved but there are individuals that declined interviews who would have been important sources of knowledge and opinion for this research.

Even though interviewees were asked to take their thoughts and views back to the time when they were actively involved with the Pool, this is not always possible. All of the interviewees have had a few years to reflect upon the events and decisions that were made during the 1980 to 2000 timeframe. Some of the statements made during the interviews may include new realizations and understandings that were not part of the interviewees' beliefs and knowledge structures in the 1980-2000 timeframe. This is part of the learning and knowledge creation process; the new experiences have reshaped their cognitive frameworks making it difficult to separate previous thoughts and views from current thoughts and views.



The work done in this thesis will become part of a larger study on agricultural co-ops that includes Agricore, Dairyworld, Saskatchewan Wheat Pool, Tri Valley Growers, Farmland, and AgWay. Conducting industry and company reviews to identify the major changes and cognition responses in each of the co-ops and their resulting failures may assist other co-ops who face similar circumstances. Background research has already been done for Dairyworld, Saskatchewan Wheat Pool, Farmland and AgWay. Personal interviews with past personnel helped to reveal views and insights at the Pool that could only be known for certain from being a part of the co-op. Implementing a case study approach using personal interviews for some of these other co-ops would be ideal.

Cognition and agency theory shed some light on the Pool's organizational failure. Exploring the interview responses further and probing for other dynamics at play could explain even more of the reasons why the Pool had to undergo debt restructuring. Further exploring the impacts of a loss in member commitment, a paternalistic management style, and a centralized structure may be of value.

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## APPENDIX A: SWP INTERVIEW QUESTIONS AND SCRIPT



Interview Questions and Script  
for Kathy Lang's M.Sc. (Ag Econ) Thesis

## **Intro**

*We are interested in what happened at the Saskatchewan Wheat Pool from the mid 1980s until 2000. This is a period where the Pool went from a dominant player in the grain handling industry to an organization in financial crisis. The Pool had over 60% of the provincial market share of grain handlings throughout the 1980s until about 1992 when market share began its descent to 33% by 2003 (the Prairie market share was 21.1% according to the 2003 Annual Report). As well, the Pool had its highest net earnings in 1981 (\$72.1 million) and it achieved positive net earnings until 1999. The Pool has experienced multi-million dollar net losses each year since 1999, which we all know culminated in a massive debt restructuring in early 2003.*

*We want to discuss with you the decisions being made within the Pool during this mid 1980s until 2000 timeframe. If you will allow us to take your thoughts and views back to your experiences at the Pool during this time we would ask that you openly share them with us and where possible we ask that you provide a clear example to illustrate your point. We will proceed through a series of six question areas starting with an overview of the period.*

## **Overview of the period**

*Could you take us back to the late 80s and early 90s (depends on when interviewee started with Pool) and give us a sense about what challenges the Pool was facing?*

1. For example, what were the most important issues/challenges facing the SWP when you were a board member/management?
2. Can you describe the environment of the grain handling industry during this time?

## **Investment decisions**

*There were approximately three major capital investments in the 1970s, five in the 1980s and 12 in the 1990s. We would like you to provide the assumptions the Pool had about the grain handling industry, its role in the industry, etc. We want to get an idea of the assumptions that investment decisions were predicated on, the analysis conducted before investing in a new venture, and why these investments were imperative.*

*If you wish, you can address this section by discussing a specific investment.*

3. What type of analysis was conducted before investing in a new venture? What objectives did the Pool hope to attain through its investments?
4. The Pool had business lines from doughnuts to ethanol – how was the decision as to which venture to invest in made?
5. What were some of the assumptions or considerations used in analyzing investment decisions? What type of analysis was conducted before investing in or purchasing new business lines?
6. The Pool was once ranked the largest grain handler in Canada; did this influence the risks and investments taken?
7. Why was there such a drastic increase in investments in the 1990s compared to the 1970s and 1980s?
8. Why do you think market share has dropped from 60% to 33% in the last decade (1993-2003)? What factors affected the Pool's market share in your opinion?

#### **Pool vis-à-vis other grain companies**

*How would you say the Pool viewed itself in comparison to other grain handling companies? Did the Pool feel it could take greater risks because of its market power?*

9. Did the management and/or board feel the Pool could take greater risks because of its market power?
10. Why do you think market share has dropped from 60% to 33% in the last decade (1993-2003)? What factors affected the Pool's market share in your opinion?

#### **Corporate culture, models, framework**

*In this section we want to get a sense of the thinking in place at the Saskatchewan Wheat Pool from the 1980s until 2000. Decisions in organizations are often based on some explicit or implicit model or framework. This model or framework influences the questions asked internally, the data collected, the conclusions reached, and actions taken.*

11. What was the corporate culture at Saskatchewan Wheat Pool during the 1980s until 2000?
12. Did the Saskatchewan Wheat Pool base its decisions with a framework or model in mind? Describe the model or framework used in a specific decision if possible.

#### **Decision-making power**

*Could you describe the decision-making process in the Pool? In your view, who possessed the power within the Pool? What was the general view within the co-op of who possessed the decision-making power?*

13. How would you describe the decision-making process at Saskatchewan Wheat Pool during the 1980s until 2000?
14. Who do you think had the real decision making power in the Pool? The members? The Board of Directors? The senior management? On what was this power based?
15. Did the source of decision making power change within the co-op after the share conversion? Did priorities shift in the sense that there was now pressure to make a return to outside investors?

**Outsiders View of the Pool**

16. You have already discussed how the Pool viewed itself in comparison to other grain companies, how do you think other grain companies (like Cargill) viewed the Pool?

*Is there anyone else you would suggest that we meet with for an interview?*

-THE END-

## APPENDIX B: INTERVIEW CONSENT FORM



## Interview Consent Form

*You are invited to participate in a study entitled: **Co-operative Structure, Corporate Governance and the Failure of Agricultural Co-operatives: A Saskatchewan Wheat Pool Case Study***

Researcher:                     Kathy Lang                     (name)

                    306.966.8411                     (phone)

**Purpose and procedure:** I would like to receive your responses to some questions about the Saskatchewan Wheat Pool's decision-making processes, investment decisions, member commitment, market share and recent debt restructuring. You have been selected because of your employment with the Saskatchewan Wheat Pool. This research project is co-ordinated by the Department of Agricultural Economics (Dr. Fulton), University of Saskatchewan. The results of this research will constitute Ms. Kathy Lang's thesis requirement for a Master's of Science degree in Agricultural Economics. This research is funded by the Social Science and Humanities Research Council of Canada (SSHRCC).

The purpose of the research is to explore the factors that led to the financial troubles (e.g., falling market share, large debt restructuring) encountered by Saskatchewan Wheat Pool since the late 1990s. This research will attempt to understand the role, if any, that co-operative structure and/or the decision-making processes that were at work within the Saskatchewan Wheat Pool may have played in the organization's financial hardships.

Your participation in this study is appreciated and completely voluntary. It is expected that the interview should last between 60 and 90 minutes. You may withdraw at any time without penalty during this process should you feel uncomfortable or at risk. All interviews will be audio taped and you have the right to shut off the tape recorder at any time if you choose. You should also feel free to decline to answer any particular question(s). Should you choose to withdraw from the study no data pertaining to your participation will be retained.

**Potential risks:** Ms. Lang will make every effort to preserve the confidentiality of your comments (see below), but you should be aware that controversial remarks, in the unlikely event they are associated with you, could have negative consequences for your relationships with others in the grain handling industry. Ms. Lang will try to ensure that your identity is protected in the ways described below. If for some reason Ms. Lang wishes to quote you in some way that might reveal your identity, she will seek your permission beforehand.

**Potential benefits:** Your participation will help document the links between co-operative structure and governance and the financial difficulties experienced by several agriculture co-operatives in Canada and the United States.

Findings from this research may help to make the co-operative sector more responsive to the needs of its members and help to inform policy decisions both within the co-operative sector and government.

**Storage of Data:** The transcripts and original audio recording of the interview will be securely stored by the Supervisor (Dr. Fulton) at the Department of Agricultural Economics for a period of at least five years.

Anonymous data will be aggregated with data gathered from other portions of this research.

**Confidentiality:** Your interview will be transcribed by Ms. Kathy Lang or by a confidential secretary. After your interview, and prior to any data being included in a final report, you will be given the opportunity to review the transcript of your interview, and to add, alter, or delete information from the transcripts as you see fit. Interview transcripts will be seen only by Dr. Fulton and Ms. Lang.

The research conclusions will be published in a variety of formats, both print and electronic. These materials may be further used for purposes of conference presentations, or publication in academic journals, books or popular press. In these publications, the data will be reported in a manner that protects confidentiality and the anonymity of participants. Participants will be identified without names being used, giving minimal information (for example what co-op they are affiliated with and whether they are board members or management) if this information is relevant. Pseudonyms or composite profiles may be used to disguise identity further, if necessary. In principle, actual names will not be used; however, leaders whose position involves speaking on behalf of the organization may be asked if certain comments they have made can be attributed to them by name in publications. Any communication of these results that has clear potential to compromise your public anonymity will not proceed without your approval.

**Right to Withdraw:** You may withdraw from the study for any reason, at any time, without penalty of any sort. If you choose to withdraw from the study, any information that you have contributed will be deleted. You will be informed of any major changes that occur in the circumstances of this study or in the purpose and design of the research that may have a bearing on your decision to remain as a participant.

**Questions:** If you have any questions concerning the study, please feel free to contact the Researcher at the number provided above.

This study was approved on ethical grounds by the University of Saskatchewan Behavioural Sciences Research Ethics Board on July 5, 2004. Any questions regarding your rights as a participant may be addressed to that committee through the Office of Research Services (966-2084).

*Consent to Participate: I have read and understood the description provided above; I have been provided with an opportunity to ask questions and my questions have been answered satisfactorily. I consent to participate in the study described above, understanding that I may withdraw this consent at any time. A copy of this consent form has been given to me for my records.*

\_\_\_\_\_  
(Signature of Participant)

\_\_\_\_\_  
(Date)

\_\_\_\_\_  
(Signature of Researcher)

\_\_\_\_\_  
(Date)

## APPENDIX C: TRANSCRIPT RELEASE FORM





## Interview Transcript Release Form

Co-operative Structure, Corporate Governance and the Failure of Agricultural Co-operatives: A Saskatchewan Wheat Pool Case Study

I, \_\_\_\_\_, have reviewed the complete transcript of my interview responses for this study, and have been provided with the opportunity to add, alter, and delete information from this transcript as appropriate. I hereby authorize the release of this transcript to the Department of Agricultural Economics, University of Saskatchewan, to be used in the manner described in the *Interview Consent Form (a)*, or the manner indicated below.

If you do not check one of the following, it will be assumed that (a) applies:

\_\_\_\_\_ (a) I prefer to remain anonymous, as described in the consent form. I understand that my remarks will not be attributed to me by name. Instead, they may be attributed to an unnamed individual (a manager, a board member etc.) or to a pseudonym or a composite profile.

\_\_\_\_\_ (b) The remarks contained in the authorized transcript may be attributed to me by name, or used anonymously, at the author's discretion.

\_\_\_\_\_ (c) I prefer to have all remarks from the authorized transcript attributed to me by name if they are used.

\_\_\_\_\_ (d) Certain remarks I have indicated by initials in the margin are to be kept anonymous as in (a) above; the rest of my comments (unmarked in the margins) may be attributed to me.

I have received a copy of this *Interview Transcript Release Form* for my own records.

\_\_\_\_\_  
Participant

\_\_\_\_\_  
Date

\_\_\_\_\_  
Researcher

\_\_\_\_\_  
Date

Kathy Lang (Researcher)  
Graduate Student, Department of Agricultural Economics  
University of Saskatchewan  
306.966.8411

## APPENDIX D: SWP INVESTMENTS AND DIVESTMENTS

**Examples of Saskatchewan Wheat Pool Investments and Divestments in the 1990s, listed alphabetically.**

<b>Company</b>	<b>Interest Held</b>	<b>Year Acquired</b>	<b>Amount Invested, in millions</b>	<b>Date Sold</b>	<b>Divestment Details</b>
Agro Pacific Industries Ltd	40%	1998	unknown	2000	\$5.1 million provision
CanAmera Foods	50%	1992	unknown	May 2002	Sold for \$58.4 million (\$7.4 million gain) to Central Soya of Canada
CanGro Aquaculture	100%	1991	unknown	July 26, 2004	Sold to Nilsson Bros.' Wild West Steelhead
Can-Oat Milling	100%	1996	\$116		Equity started at 13.25% in 1996; Increased to 34% in 1997 and to 100% in 1998
Comer. La Junta (Mexico)	50%	1997	\$8.5 US	June 15, 2004	\$24.6 million provision
CSP Foods	100.0%	1975	unknown	February 2002	Sold to Dawn Foods for \$34.57 million (\$21.58 million gain); sale included Humboldt Flour Mills
Europort (Poland)	53%	1997	unknown	December 7, 2000	\$35.0 million provision; Started with \$8.5 million initial investment (10% equity), grew to 53% by 1999
Heartland Feeds	100%	1997	unknown	November 2001	Sold to Nilsson Bros. for \$11.2 million (\$12.75 million loss); Included mills at Taber, Dauphin, Regina, Picture, Bruno
Heartland Livestock Services	89.8%	1994	unknown	August 29, 2001	Sold for \$23.5 million (\$5.3 million gain) to Nilsson Bros.
Heartland Pork	89.6%	1997	\$75	May 14, 2004	Estimated \$12 million/barn with 50% investment; Seven barns sold to Stomp Pork Farms' subsidiary for a estimated \$22.4 million
Humboldt Flour Mills	100%	1998	\$26.2	2002	Sold with CSP Foods to Dawn Foods

Matrix Trading (England)	50%	1997	unknown	2000	\$6.9 million provision
North Battleford feedmill	100%	1998	\$8	January 2000	
Northco Foods	35%	1987	unknown	March 1, 2000	Robin's Donuts parent company; sold to Afton Group Inc. of Burlington ON
Premium Brands	41%	1997	\$51.9	July 2001	Sold for \$46 million (\$20.1 million loss); formerly Fletcher's Fine Foods; 35% initial equity
Western Producer	100%	1923	unknown	January 9, 2002	Sold for \$11.6 million to GVIC Communications Inc.
XCAN Grain Pool Ltd	33.3%	1970	unknown	January 2001	Sold for \$11 million to remaining shareholders

Source: SWP Annual Reports, 1997-2005.