

## The Conversion of Agricultural Cooperatives to Companies in South Africa

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**Abstract:** In the late 1990's many cooperatives in South Africa and especially those of an agricultural nature, converted into (limited liability) companies for various reasons. This study will highlight the differences between cooperatives and companies in aspects ranging from initial capital to membership interest of the business models. An explanation of the possible reasons on agricultural cooperatives changing to companies will follow. Statistical data on cooperatives will be emphasized and the three significant conversions: Cooperative Wynbouers Vereniging (KWV), SUIDWES and Oos-Transvaalse Landbou kooperasie (OTK) will be conferred in detail. In conclusion: decisions regarding conversions should rather be based on the specific, realistic situation and interest involved in the case at hand.

**Key words:** Agricultural cooperatives, companies, conversion, realistic, interest

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### INTRODUCTION

There is currently a vacuum in academic literature regarding the conversion of a cooperative to a company in South Africa. As a result, many people are uninformed or even misinformed about what constitutes the conversion from a cooperative to a company in South Africa.

The early history of modern cooperatives in South Africa goes back to the period after the Anglo-Boer war when cooperatives were promoted as a means to improve agriculture (Satgar, 2007). The cooperatives were given a fundamental role in managing legal marketing systems. Although their primary function was the commercialization of agricultural output, in practice, they came to operate throughout value chains, from input and credit supply to distribution, sales and exports (Amin and Bernstein, 1996). The first formally registered cooperative in South Africa was the Pietermaritzburg Consumers Cooperative which came into existence in 1892 regarding the Companies Act. At this stage, there was no legal framework dedicated to cooperatives. In the case of agriculture, this was followed by the establishment of the National Cooperatives Dairies Limited in early 1900 in the then Natal. Cooperatives became a great vestibule for agriculture, holding an effective monopoly in the main agricultural areas, backed by ready access to finance through the Land Bank and with sufficient control of the Marketing Boards that regulated prices until this system was undone post-1994 (Philip, 2003).

After 1994, the democratic government did not consider Cooperative Act No. 91 of 1981 as relevant for the development of cooperatives in the current era for different reasons. The reasons were: insufficient definition

of a cooperative; assumption that the state plays a highly dominant or overprotective role about cooperatives; provisions protecting members' interest, particularly regarding the board of directors, are poorly spoken and burdensome requirements to register a cooperative. In August 2005 a New Cooperatives Act No. 14 of 2005 was signed by the government of South Africa as the law which is based on the international cooperative principles (Maciya, 2012).

In the late 1990's many cooperatives and especially those of an agricultural nature, converted into (limited liability) companies. The Minister of Agriculture, at the time, Derrick Hanekom, took legal action to attempt to stop KWV (Ko-operatiewe Wijnbouers Vereniging van Zuid-Afrika) from doing so. He stated that cooperatives had benefited from a range of forms of state support for decades. Therefore, allowing them to build an effective monopoly and that the converting into a company would result in asset-grabbing. This case was settled out of court in 1998 and the conversion went ahead, as did other, such as OTK and Senwes (Schoeman, 2006).

### AGRICULTURAL COOPERATIVES AND COMPANIES AS BUSINESS MODELS A COMPARISON

This study aims to draw a brief comparison between the agricultural cooperative and the company referring to differences and similarities of both. This comparison is drawn because the company is an enterprise which finds its use more regularly in the economy. Therefore the aim is to familiarize the reader with the differences and similarities of a company and to compare those to agricultural cooperatives. The differences include initial

capital, a division of profits and termination of membership. The similarities refer to membership, the board of directors, legal personality and liability of the business models.

An agricultural cooperative has the advantage of requiring less initial capital to start the business model than in the case of the company. In an agricultural cooperative, initial capital is always obtained from the members, the amount of which is determined by the constitution of the agricultural cooperative. In a company, initial capital is obtained from various entrepreneurs who pool money. In a company with share capital, capital is acquired by issuing shares to persons (Schoeman, 2006).

The difference between the ways that profits are divided, as the division of the benefits of a company is based on dividends declared while the cooperative bases its division of profits on the usage proportion. Regarding termination of membership, the agricultural cooperative sale of shares is much more rigid to dispose of than shares held in a company (Cilliers *et al.*, 2000).

The similarities between the two business models are a free and open membership, a free selection of the board of directors, legal personality and having limited liability (Schoeman, 2006).

#### **POSSIBLE REASONS FOR AGRICULTURAL COOPERATIVES CONVERTING INTO COMPANIES**

Tax liability, the growing need for increased profit-making as the primary objective and legal restrictions previously placed on the agricultural cooperatives are possible reasons for conversions of agricultural cooperatives to companies.

**Tax liability:** A tax advantage is one of the considerations regarding the conversion of an agricultural cooperative to a company. On 1 April, 1997, the Income Tax Act was amended whereby agricultural cooperatives became liable for tax in the same way as the company. The tax legislation indicates that both the agricultural cooperative and the members of the cooperative are taxable. Bonuses paid out to members are tax- deductible, according to Section 27 of the Income Tax Act of 1977 which implies that it is much more beneficial for the agricultural cooperative to pay out these bonuses in cash than to retain them within the agricultural cooperative structure and as a result pay tax on them. Currently, cooperatives do not have tax advantages over companies.

**Legal restrictions:** The legal restrictions previously placed on agricultural cooperatives made companies as a business model more sustainable and flexible are as follows:

The Agricultural Cooperatives Act, 14 of 2005 does not make any provisions for ministerial permission for the agricultural cooperative to buy shares in companies or to invest in a company. There have always been restrictions on the attainment of membership shares within an agricultural cooperative. Agricultural cooperatives are prohibited from selling shares directly to the public and no share may be issued unless at least a tenth of the nominal value of such share has been paid to the cooperative (Anonymous, 2005).

Also, no member has a claim on the reserves of the agricultural cooperative. However with the enactment of the Agricultural Cooperatives Act 14 of 2005, profits may only be divided among the members by the investment proportion.

Previously, according to the Agricultural Cooperatives Societies Act 91 of 1981, loans to members were restricted to 50% of the share capital and the reserves of the agricultural cooperative; however this could be amended by special resolution. This provision was omitted from the Agricultural Cooperatives Act 14 of 2005, which implies that the granting of a loan, as well as the proportion of the shareholding and the reserve of the agricultural cooperative that will be affected, will be done at the discretion of the members.

Therefore, it is clear that the legal restrictions in respect of agricultural cooperatives as a business model have become less strict since the enactment of the 2005 Agricultural Cooperatives Act 21 This amendment makes agricultural cooperatives more open as business models.

**The growing need for increased profit-making as the primary objective:** It is important to note that the membership interest in agricultural cooperatives is not regarded as an investment. The agricultural cooperative rather offers other benefits than investment value, such as bulk buying, the negotiation of lower interest rates and insurance premiums and the provision of better quality and lower priced services. However, the value of membership does sometimes require the conversion into a company or otherwise comparative voting rights to be implemented within an agricultural cooperative structure. This happens when one member compared to another member has an adequately higher capital interest combined with an increased risk component. In such a situation it is sometimes advisable to convert the agricultural cooperative into a company so that increased management control and voting rights can be obtained (Cilliers *et al.*, 2000).

A decision to convert the agricultural cooperative into a company or to allow proportional voting rights

should be made to accommodate best both the economic interest of the member with a higher risk element as well as the benefit of the members that do not.

**STATISTICAL DATA ON AGRICULTURAL COOPERATIVES CONVERTING TO COMPANIES**

Following the route of the Agricultural cooperatives Amendment Act of 1993, permitting cooperatives to expand their range of business and to convert into companies, cooperatives turned to companies as a business model (Sikuka, 2010). In the late 1990s many agricultural cooperatives and especially those of an agricultural nature, transformed into (limited liability) companies for different reasons.

New company registrations have increased rapidly since 1985 but the fastest growth was experienced in the post-1994 period, increasing from 895 per year in 1993 to as many as 1 879 in 1997 an increase of 209% over the number in 1993.

After receiving statistics from the Registrar of Cooperatives relating to de-registrations and conversions in 1998-2005 the following summary was compiled: from the Table 1 there have been 51 conversions of agricultural cooperatives to companies between 1st January 1998 and 2nd March 2006. In 2000 and 2006 there have been zero conversions and in 1998 the highest number (19) of conversions during 1998-2006. The three significant conversions were Cooperative Wynbouers Vereniging (KWV), SUIDWES and Oos-Transvaalse Landboukooperasie (OTK).

**Cases of conversions**

**Ko-operatiewe Wijnbouers Vereniging van zuid-Afrika (KWV):** In 1918, the year Nelson Mandela was born, South African wine farmers founded KWV with the aim of stabilizing, supporting and structuring an undeveloped, struggling industry. Until the early 1990s when world markets opened to South African wine, KWV played a central role in regulating the industry. Since then, KWV

has transformed itself into a profitable competitor, exporting award-winning wines and brandies from its main cellar in Paarl all over the world (NAMC, 2002; Graan, 2010; Eeden, 2009).

Following deregulation in the 1990s, the wine industry was the site of critical contestation over control of the pool of assets. This involved KWV, South African Breweries (SAB) and the state which resulted in the merger of Stellenbosch Farmers’ Winery (SFW), a cooperative and Distillers, a private company, to form a new company called Distell in 2000 (NAMC, 2002).

Within the reduction of direct government support and with the possibility of the government becoming hostile towards them, cooperatives like KWV and the Eastern Transvaal Cooperative (OTK) decided to privatize to build up their internal capacity.

In 1997 KWV converts from a cooperative to a company with the support of its members who became the shareholders of the new company and with restrictions on trading of shares. It was a much-detested move for the government and the minister of agriculture at the time, Derrick Hanekom, even took legal action against KWV in an attempt to stop them from converting into a company. He held that government’s continued support of the agricultural cooperative had assisted the agricultural cooperative to acquire a certain number of assets and therefore if the agricultural cooperative were allowed to convert into a company, it would result in asset-grabbing by the agricultural cooperative. Regardless of this challenge, KWV still transformed into a company after a settlement regarding which KWV undertook to donate a significant amount to a public development trust. In 2003, restrictions on KWV share trading was lifted and shares made available to the general public.

**Senwes:** At the end of January 1995, on account of changed national legislation concerning agriculture and also based on international trends in which agricultural practices were inclined to move from a cooperative to a free market system, the Senwes management decided to investigate the possibility of forming a company.

Experts outside the cooperation were consulted. This need was further encouraged by members of Senwes, as is evident from the minutes of the directors in February 1995 (freely translated from Afrikaans): it is reported that members from several regions have already requested that Sentraalwes must see external experts investigate the possibility of forming a company. Undoubtedly, the new government is going to address the cooperative system and the protection the cooperative system has enjoyed up to now will probably cease. The opinion is that

Tble 1: Statistical data on agricultural cooperation

Years	Conversions
1998	19
1999	13
2000	0
2001	8
2002	4
2003	1
2004	2
2005	4
2006	0
Total	50

Sentraalwes can do nothing else but consider forming a company due to the danger of possible manipulation in a new era (Eeden, 2009).

Several pros and cons concerning converting to a company were reflected on. One of the disadvantages was that cooperative members would lose control over their affairs because a take-over from outside was inevitable. While cooperation's in many respects got off lightly concerning income tax legislation in the past, in a company structure it could imply a larger cut of the annual revenue. The standing reserves of the cooperative in a new political dispensation could lead to claims. For fear of interference in the cooperative industry by the government, some members of the board of directors and cooperation supported the formation of a company. Therefore ensuring that the accumulated and ownerless reserves were in the hands of shareholders and to be able to access other capital markets (Eeden, 2009).

Already in 1996, Senwes started preparing to transform from a cooperative into a company. In the process, provision was made for so-called "nameless" reserves accumulated over time by the cooperation to be converted into share capital for the shareholders.

To get clients and shareholders so far to change after so many years of a cooperative approach was a challenge. The transformation process proceeded after March 1997 as part of the process to explore and exploit the free market with profit seeking as an important objective. Several assets were acquired in the process which sent Senwes further into the whirlpool of a diversified environment. Purchasing the Vaalharts Cooperation in the Vaalharts scheme by December 1996 is a typical example of this. Furthermore, the issuing of shares in Senwes Ltd. to members of the Vaal harts Cooperation was an important aspect of the take-over (Eeden, 2009).

The formation of the company took place on 10 April, 1997. It led to a transformation in virtually every department of Sentraalwes which is currently known as Senwes.

**Oos-Transvaalse landbou Kooperasie (OTK):** In 1923 the Oos-Transvaalse Landboukooperasie (OTK) was founded by 29 farmers providing storage and technical services to farmers in what is now Mpumalanga.

OTK, based in Bethal, was one of the two biggest summer grain cooperatives; the other was Senwes, the Central West Transvaal Cooperative, headquartered in Klerksdorp, which is the single largest trader of white maize, wheat and sunflower seed.

The Eastern Transvaal Cooperative and the Delmas Cooperative merged in 1985 and in 1988 the name was

changed to OTK (Cooperative) Limited. In 1996, OTK converted to a company and was listed on the JSE. In 2003, OTK's name changed to AFGRI. The reasons given by OTK for the conversion included: raising capital to strengthen its capital base and to spread risks widely among shareholders; to release member's locked up funds through the issuing of shares; to bring about greater business flexibility and to attract partners, external expertise and foreign capital. Thus, the OTK was, in a sense, seeking to replace government assistance with private sector support and the indication is that this has been successful so far (Schirmer, 2000).

After OTK's conversion into AFGRI, the company expanded its activities and made some acquisitions, including Laeveld Ko-op, Natal Agricultural Cooperative and Nedan Oil Mills, Daybreak Farms, Rossgro Chickens in 2010 and Pride Milling in 2011. AFGRI today consists of three main segments: AFGRI Agri Services housing the assets and operations from the original farmers' cooperative; AFGRI Foods containing the Group's investments in poultry and industrial food processing assets; and AFGRI Financial Services which provides financial products to customers in the primary agricultural sector, the food processing industry and the Group as a whole.

As a cooperative, the original OTK had a reputation for being a forerunner, always willing to change its way of doing business to meet market demands and modifications. AFGRI seems to have taken this vision and mission with it as it has become a company, listed, expanded and diversified.

## CONCLUSION

Within the reduction of direct government support and with the possibility of the government becoming hostile towards them, cooperatives decided to privatize. KWV, SENWES and OTK concluded that undoubtedly, the new government was going to address the cooperative system and the protection the cooperative system has enjoyed would probably cease. The reasons SENWES considered were:

- Income tax legislation which in a company structure could imply a larger cut of the annual revenue
- Standing reserves of the cooperative in a new political dispensation could lead to claims
- Accumulated and ownerless reserves in a company were in the hands of shareholders and be able to access other capital markets
- Process in a company to explore and exploit the free market with profit seeking as an important objective is possible

- Several assets were acquired in the conversion process which sent Senwes into a diversified environment

The reasons OTK provided for the conversion included:

- Raising of money to strengthen its capital and spread risks among shareholders
- Releasing member's locked up funds through the issuing of shares
- Greater business flexibility and attracting partners, external expertise and foreign capital

Therefore, tax liability, the growing need for increased profit-making as the primary objective and legal restrictions previously placed on the agricultural cooperatives are reasons for conversions of agricultural cooperatives to companies.

Finally as stated above, there are many reasons for agricultural cooperatives to convert into companies as a business model. Some of these reasons are surely defensible and should not result in a negative stigma in an agricultural cooperative structure as a whole. There is no overall rule and decisions in this regard should rather be based on the specific, realistic situation and interest involved in the case at hand.

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