

# Integration and New Business Challenges in Agricultural Co-operatives in Japan

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# Profile of Presenter

- Professor, Co-operative Program, Institute for Solidarity-based Society, at Hosei University (ISS-HU), Tokyo
- Director of Consumer Co-operative Institute, Tokyo
- Chair of the ICA Research Committee (2001-2005) and Vice chair of the ICA Asia Pacific Research Committee (2000-)
- Vice chair of Japanese Society for co-operative studies (2003-2007)
- Member of the CIRIEC Scientific Commission “Social/Co-op Economy”
- Member of the ICA Principles Committee
- Member of the ICA World Co-operative Monitor Steering Committee
- Coordinator of Global Co-operative History project (2009-)
- Specialized in co-operative law, economics/management, history etc.

# Outline of presentation

- Introduction
- Integration and supply/value chain as analytical framework
- Structure of the JA Group
- Integration process in the JA system
- Integration process in the food supply chain
- Problems in the integration process
- New business challenges in the JA Group
- Conclusion

# Introduction

- Japanese Agricultural Co-operatives (JAs) have a sheer size in the World Co-operative Monitor ranking (Zenkyoren, Zen-noh) and in the domestic market (rice 50%, vegetables 54%, beef 63%, fertilizer 77%, chemicals 60%, machines 55%).
- They are characterized by **three-tier “Keitou” system** in parallel with administrative divisions and **multipurpose co-op model** including supply/marketing and financial businesses.
- This presentation focuses on the integration process and business strategies of JA’s supply and marketing functions that are obliged to restructure by new legislation and to enhance profitability and competitiveness in more globalized market.

# Introduction

- 2013 World Co-operative Monitor for 2011 data (\*USD billion)

	Organization	Country	Turnover*	Sector
1	Zenkyoren	Japan	81.69	Insurance
2	Zen-noh	Japan	62.44	Agriculture/food
3	Nippon Life	Japan	61.99	Insurance
4	State Farm Group	USA	57.13	Insurance
5	Rewe Group	Germany	52.22	Wholesale/retail
6	Meiji Yasuda Life	Japan	49.93	Insurance
7	E.Leclerc	France	49.05	Wholesale/retail
8	Kaiser Permanente	USA	47.90	Insurance
9	Groupe Cr�dit Agricole	France	45.49	Banking
10	Sumitomo Life	Japan	37.98	Insurance

# Business integration

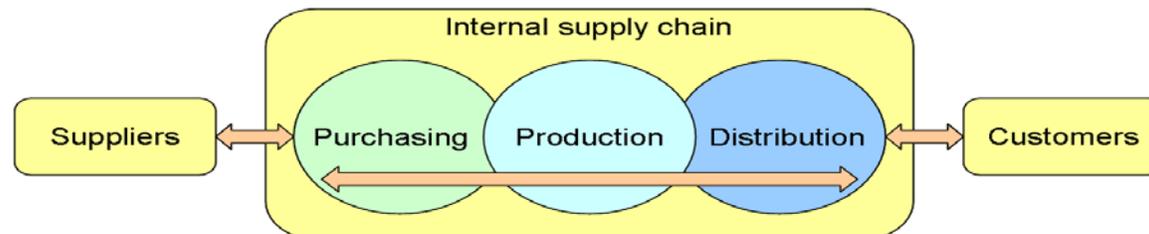
- Business integration in a network of firms between hierarchy and market
- Modes of business integration
  - Merger and acquisition (M&A)
  - Strategic alliance: federation or coalition
  - Joint venture
- Three types of business integration
  - Horizontal integration among primary co-ops
  - Vertical integration between primaries and federations
  - Conglomerate integration

# Business integration

- Purposes of business integration
  - Attaining economies of scale for cost reduction and bargaining power
  - Intensifying organization's management
  - Facilitating investment in the growth area
- Tasks to complete business integration
  - Restructuring to streamline operations by reducing workforce and/or branches/tiers
  - Strengthening specialized functions
  - Mitigating problems of greater distance with stakeholders

# Supply chain and value chain

- The supply chain has evolved to secure buying from suppliers or selling to customers. The food manufacturers made forward integration of distributors or backward integration of suppliers to enhance control of the flow of products while the large distributors made backward integration of processors or even primary industries.
- Commonly accepted definition of Supply Chain Management (SCM)  
“the management of upstream and downstream value-added flows of materials, final goods, and related information among suppliers, company, resellers, and final consumers”.



# Supply chain and value chain

- Value chain by Michael Porter  
“The idea of the value chain is based on the process view of organizations, the idea of seeing a manufacturing (or service) organization as a system, made up of subsystems each with inputs, transformation processes and outputs. Inputs, transformation processes, and outputs involve the acquisition and consumption of resources - money, labor, materials, equipment, buildings, land, administration and management. How value chain activities are carried out determines costs and affects profits.”

Michael Porter's Value Chain



# Supply chain and value chain

- Needs to combine supply chain and value chain
  - Supply chain involves elements of production, physical distribution and inventories, and consumption aiming at lowering transaction costs (efficiency).
  - It also involves elements of shared information, traceability and sustainability aiming at securing quality and safety of food.
  - Value chain relates to formation of consumer values and communication with consumers, aiming at shared interests and partnership among players.
  - Supply chain and value chain need to be combined to innovate food chain as a whole bringing win-win relations among actors.

# Supply chain and value chain

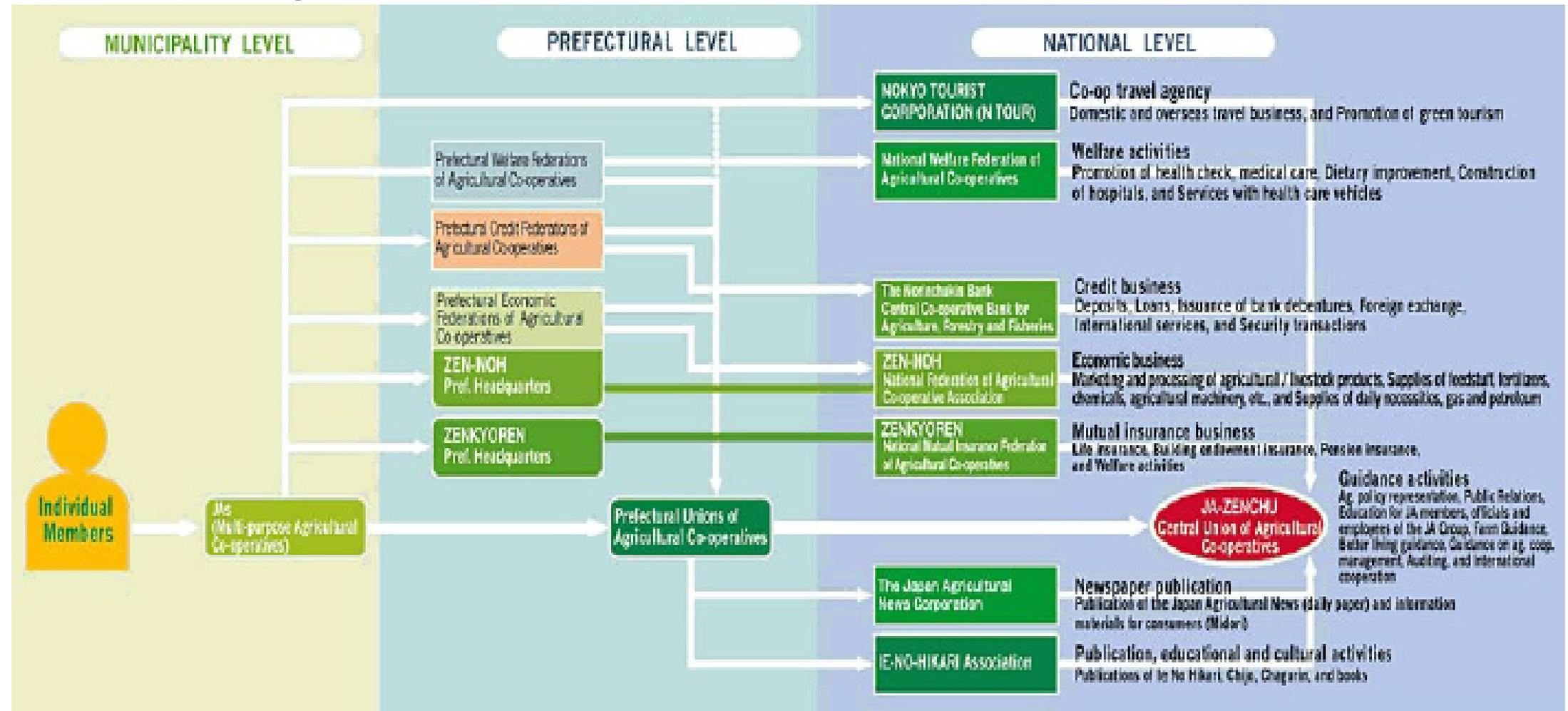
- Co-operatives aim to improve supply chain and value chain
  - By cutting middlemen (direct transaction)
    - Direct marketing: Farmers markets → freshness, locally grown
    - Direct sourcing: Consumer-led *Sanchoku (Teikei)* → freshness, safety and reliability
  - By integrating upstream
    - Consumer co-op's commissioned production of store brands → safety and reliability
    - Agricultural co-op's investment in production of inputs → lower price
  - By integrating downstream
    - Agricultural co-op's investment in processing of produce → higher income
    - Agricultural co-op's involvement with multiple retail channels → higher income

# Structure of the JA Group

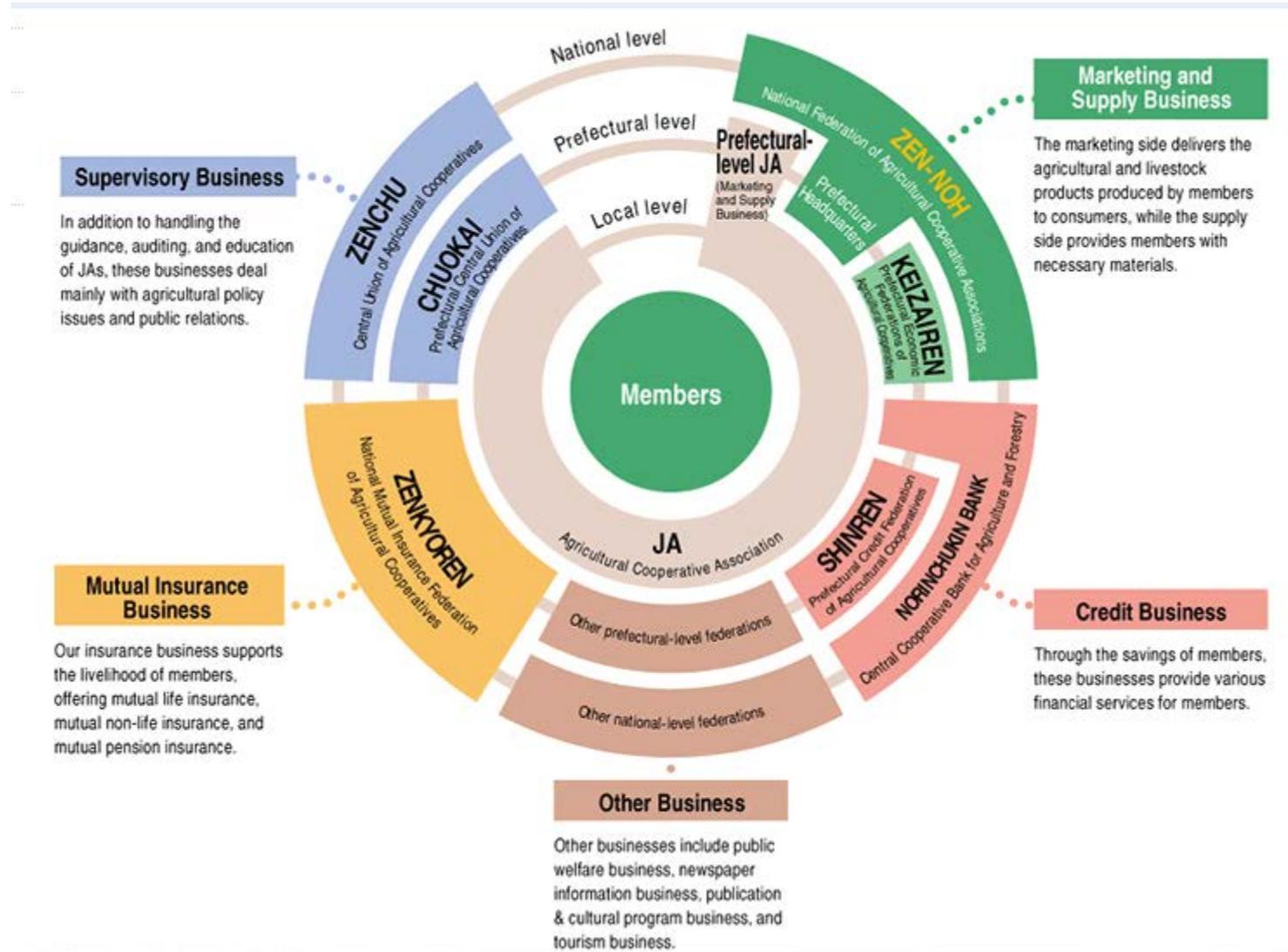
- JAs covers all farmers (regular members) and local residents (associate members) that outnumbered the former in 2008.
- JAs consist of multipurpose co-ops (operating supply/marketing/banking/insurance/health & social care/realtor/travel/media etc.) and specialized co-ops (e.g. dairy, livestock, citrus fruits co-ops).
- Three-tier *Keitou* system (primary co-ops, prefectural and national federations) was built in parallel with public administration system (municipalities, prefectures and national government). Intensified competition forced JA group to shift to two-tier system since the 1990's.
- JA's marketing is based on commission sales to wholesale markets (path thru) rather than direct transaction with demand sides taking risks.
- JA group has been coordinated by JA Kenchu (Prefecural Unions) and JA Zenchu (Central Union) as apex organizations specially designated by the governments.

# Structure of the JA Group

## JA Group's organizational structure



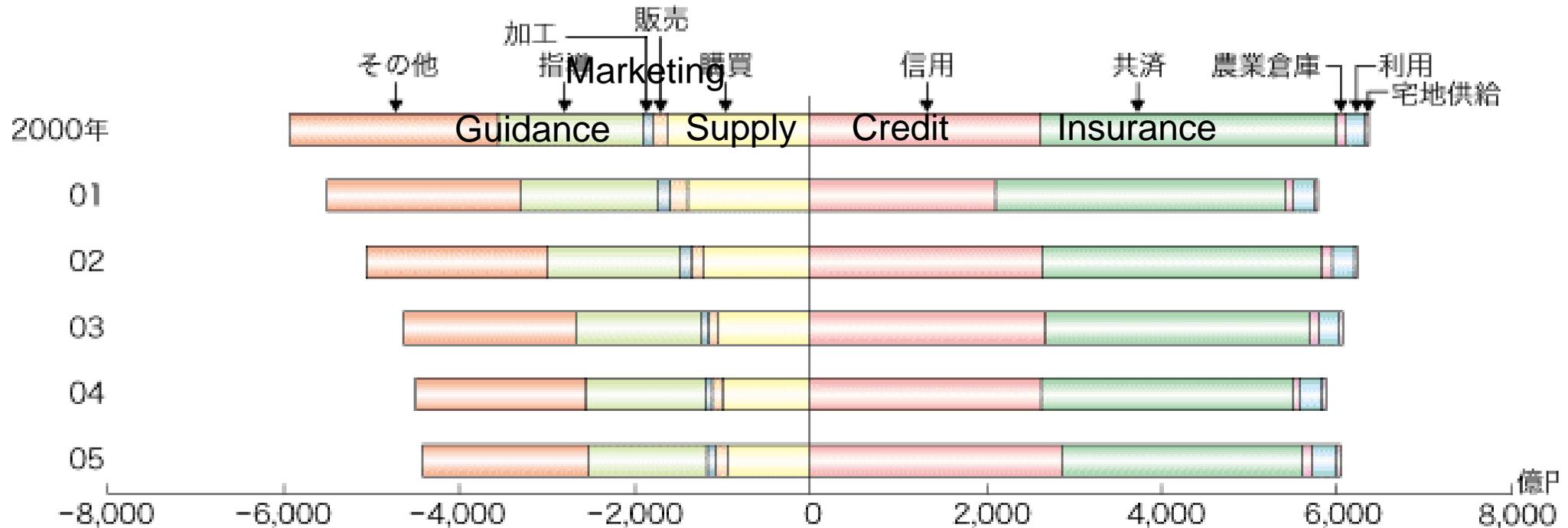
# Structure of The JA group



# Structure of the JA Group

JA's loss-making supply/marketing businesses subsidized by financial ones

図2-66 総合農協における各事業別収支の推移



資料：農林水産省「総合農協統計表」を基に農林水産省で作成

In JPY 100 million

注：1) 各事業別収支は、各事業別担当職員数割で事業管理費を各事業別に配分し、各事業の総利益から差し引いて算出した。

2) 利用とは、ライスセンター等組合員の共同利用施設の設置（医療・福祉等に関するものは除く）事業であり、その他は農業生産（受託農業経営等）、医療・福祉、生活文化に関する事業等を含む。

# Integration process in the JA system

- Three types of integration
  - Horizontal integration among primary co-ops
  - Vertical integration between federations
  - Conglomerate integration (Zen-noh)
- Factors prompting integration
  - Intensified competition due to trade liberalization and deregulations
  - Accelerated mergers of municipalities as counterparts of JAs in the field of agricultural policies (from 3,232 in 1999 to 1,718 in 2014)
  - JA decisions pertaining to integration process
    - 18th National JA Congress in 1988 resolved to consolidate to 1,000 co-ops toward 2000.
    - 19th National JA Congress in 1991 resolved to consolidate *Keitou* system from three-tier to two-tier system of primary and national levels.

# Integration process in the JA system

- Horizontal integration among primaries
  - Kenchu and Zenchu have promoted mergers of primary co-ops to increase competitiveness or to rescue ailing co-ops.
  - Gov't offered supportive legal/fiscal measures by the Law Promoting Mergers of Agricultural Co-ops that took effect in 1961.
  - Number of JAs was reduced to 703 in 2014, 41% of municipalities.
  - As a result, the average size of JA members increased from 5,632 in 1999 to 14,249 in 2013.
  - Single prefecture-wide JAs have been created in 5 out of 47 prefectures (Nara, Kagawa, Shimane, Okinawa and Saga).

# Integration process in the JA system

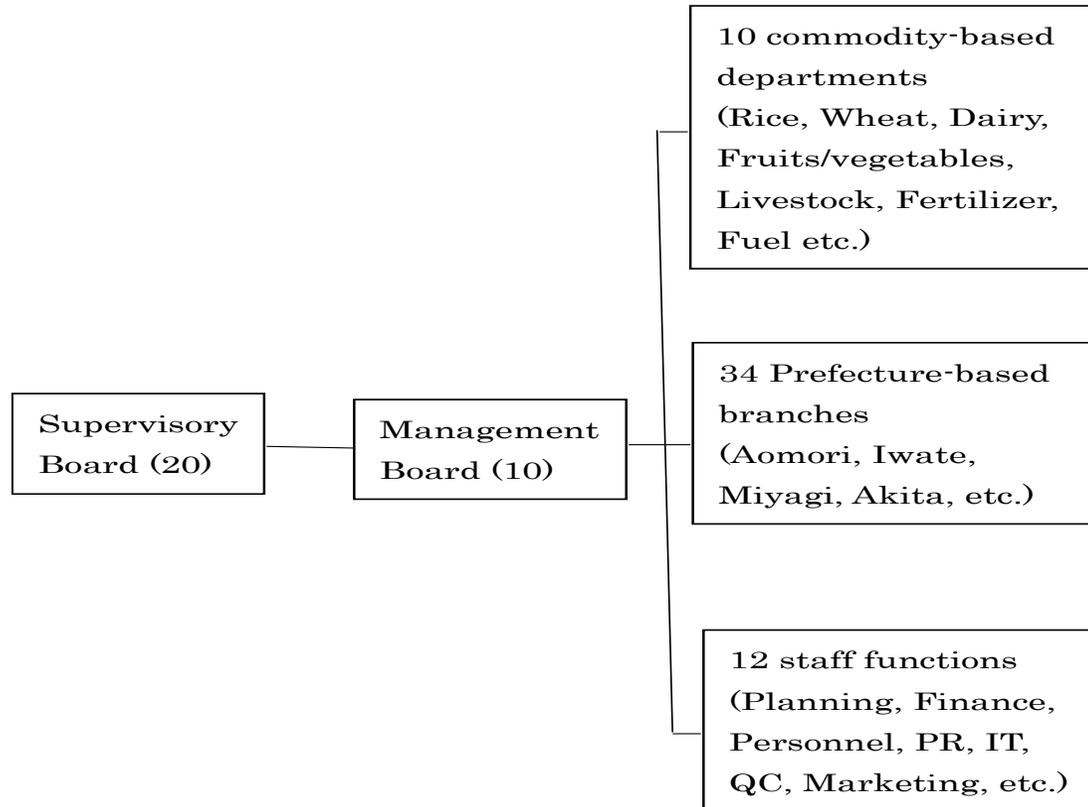
- Vertical integration between federations
  - 34 prefectural supply/marketing federations were integrated in Zen-noh and became prefectural branches. But these federations are not fully integrated in Zen-noh (in particular financial and personnel management), and often cause scandals (e.g. disguised labelling, unfair trade practices, cartels etc.).
  - 5 prefecture-wide JAs took over prefectural supply/marketing federations.
  - 8 prefectural supply/marketing federations remain independent. Most of them are economically strong. In particular, Hokuren (Hokkaido federation) has its own distribution system and sometimes competes with Zen-noh.
  - It means Zen-noh has three types of members.
    - Primary JAs under the integrated prefectural federations
    - Prefecture-wide JAs
    - Independent prefectural federations

# Integration process in the JA system

- Conglomerate integration (Zen-noh)
  - Zen-noh was founded as a result of merger between the National Supply Co-op Federation and the National Marketing Co-op Federation in 1972.
  - Zen-noh integrated 34 prefectural supply/marketing federations as its branches and absorbed the latter's subsidiary companies.
  - Zen-noh now owns more than 120 subsidiary companies in agri-food businesses, energy-related businesses, housing etc. in both domestic and international markets.
  - As a result, Zen-noh has the complicated organizational structure with commodity-based departments and territorial branches, backed by 12 staff functions.
  - In this regard, Zen-noh has grown as a conglomerate agribusiness, often being regarded as one of major trading houses such as Mitsubishi and Mitsui.

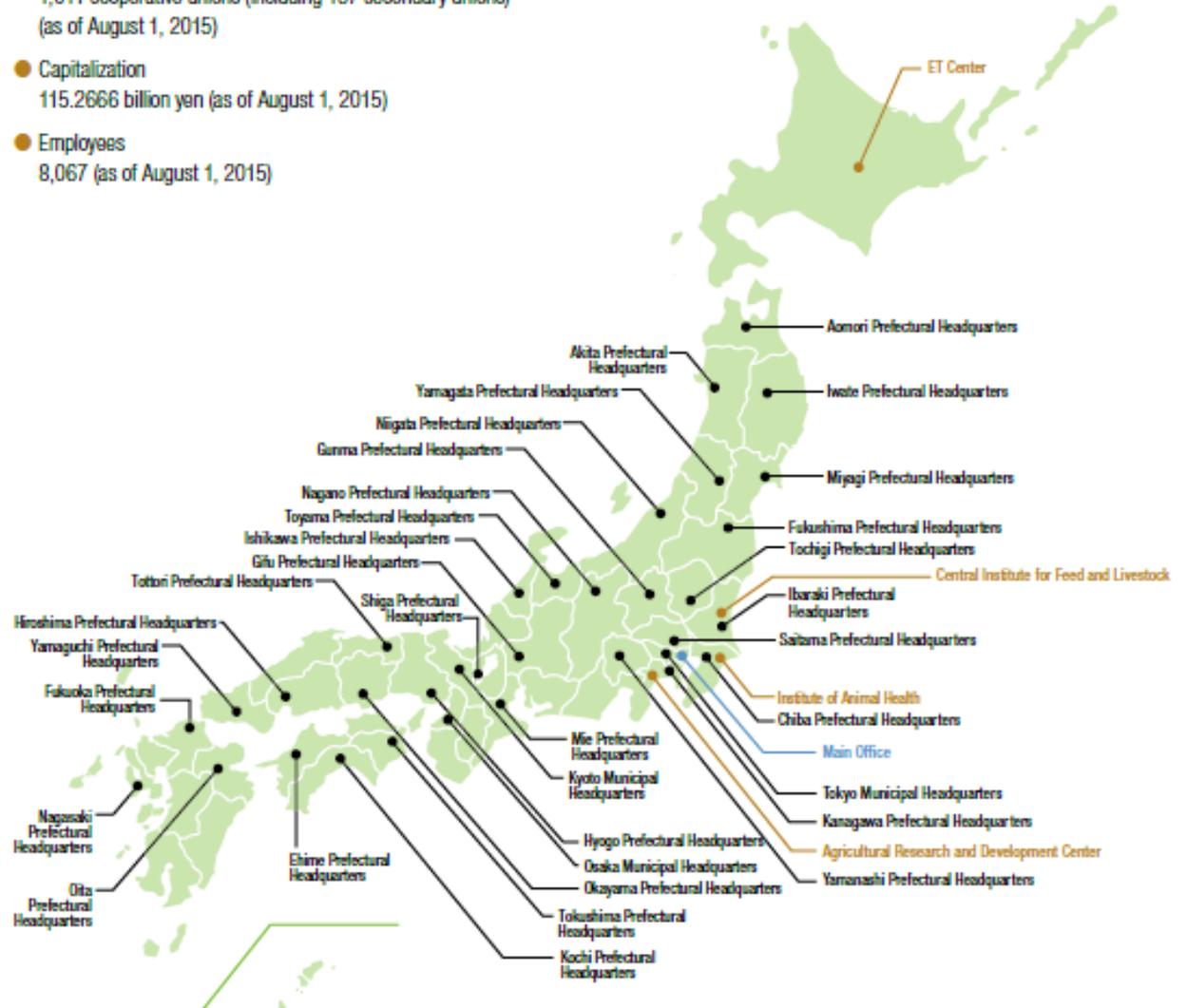
# Integration process in the JA system

- Organizational structure of Zen-noh



# Zen-noh

- Membership  
1,011 cooperative unions (including 157 secondary unions)  
(as of August 1, 2015)
- Capitalization  
115.2666 billion yen (as of August 1, 2015)
- Employees  
8,067 (as of August 1, 2015)



# Integration process in the food supply chain

- Cases of forward integration
  - JA Nakasatsunai (soya)
  - JA Tomisato (vegetables)
- Case of backward integration
  - Zen-noh Grain (compound feeds)
- Factors prompting integration
  - Intensified international/domestic competition
  - Needs to earn added value due to lowering share of producers' income
  - Supportive public policy for the “Agriculture-Commerce-Processing Alliance” or the “6th industry linking 1st, 2nd and 3rd industries”.

# Integration process in the food supply chain

- JA Nakasatsunai (Hokkaido)
  - Processing and marketing of high-quality *edamame* (soybeans in pods)
  - Enlarged acreage and enhanced farmer's income
  - Factors attributable to success
    - Development of frozen *edamame* by introducing state of art harvesters and processing machines (boiling and quick freezing within 3 hours after harvest) .  
The frozen *edamame* can be traded/exported throughout the year meeting buyer's requirement at any time.
    - JA buys all crops so that farmers can expand acreage with security.
    - Visionary president's active sales promotion resulting in trading with more than 240 supermarkets and food businesses including in the USA and Hong Kong.
    - Commitment to food safety by designating chemicals, checking pesticide residue and obtaining HACCP recognition.

# Integration process in the food supply chain

- JA Tomisato (Chiba Prefecture)
  - Developing multiple channels for marketing fruits and vegetables
  - Enhanced direct transaction to 37% resulting in halved commission
  - Factors attributable to success
    - Direct transaction to supermarkets, restaurants, food processors and farmers markets where JA coordinates farmers, matches supply/demand, concludes contracts and makes settlements since 1995
    - Direct sales in 'shoppe in shop' where farmers do pricing and pay rents since 2003
    - Joint venture with Ito Yokado Group for composting/recycling of garbage in shops
    - Involvement in the next stages (retail packaging, primary processing) to meet downstream's needs

# Integration process in the food supply chain

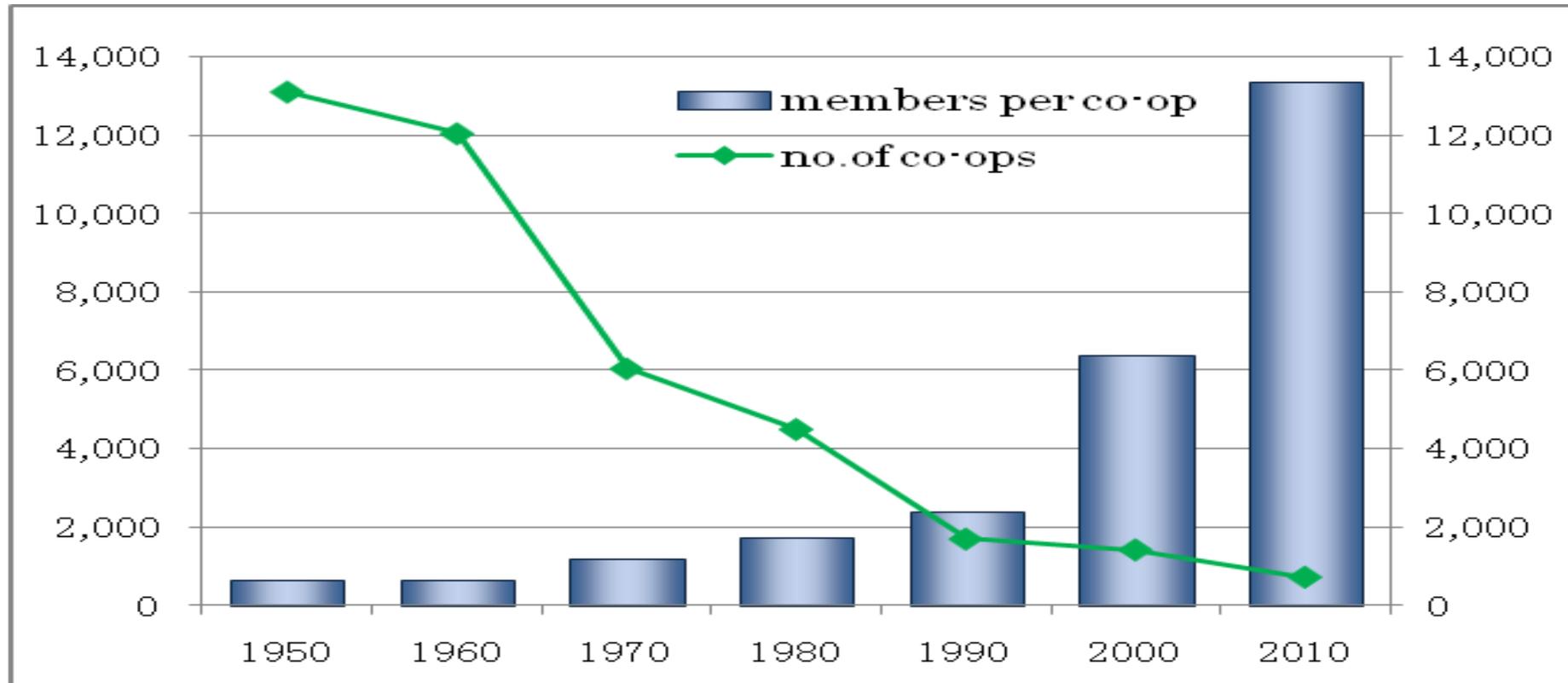
- Zen-noh Grain Co.(ZGC)
  - Direct involvement in procuring grains for compound livestock feeds
  - Import 10% of grains from the USA competing with Major firms (Cargill etc) or Zen-noh group controls 30% of compound livestock feeds
  - Factors attributable to success
    - Founded to coordinate the whole supply chain from producers, elevators to importation in 1979
    - Contracted co-op farmers in the (co-op to co-op, farm to farm trade)
    - Bought Consolidated Grain and Barge (CGB) as a consolidation business
    - Equipped with huge grain elevators in New Orleans
    - Distribution of post-harvest free and non-GM grains responding consumer demands

# Problems in the integration process

- As a result of mergers, the number of JAs has been reduced to 679 but member's patronage and labor productivity in larger co-ops is lower than that in smaller ones. Business integration must attain higher productivity while addressing larger distance from members.
- Vertical integration is taking place slowly while resourceful federations (Hokuren etc.) are reluctant to join Zen-noh.
- Zen-noh has been often criticized for high input price, abuse of power, disguised labeling etc.
- Farm Minister requested Zen-noh "to reform or to dissolve" in 2002. The MAFF published 3 reports for JA reforms during 2000-2009 and recommended Zen-noh to establish governance as a nationally integrated entity or to be divided into regions/prefectures in 2009.

# Problems in the integration process

- Mergers reducing number of JA



# Problems in the integration process

- Comparison of patronage and performance of agricultural co-ops in 2010

Size of full members	Deposit per member*	Marketed per member*	Ratio of overhead (%)	Labor productivity*
less than 1,000	10,754	9,673	89.9	9,069
1,000–5,000	10,246	1,196	89.4	8,817
5,000–10,000	9,005	720	90.5	8,372
more than 10,000	8,204	678	91.8	8,233
total	8,872	895	90.8	8,421

# New business challenges in the JA Group

- Shift in food consumption/production and deregulation
  - Changing pattern of food consumption due to westernized lifestyle
  - Decaying food production basis: eroding farmland and ageing farmers
  - Resulting decline of food self-sufficiency from 79% to 39% in 1960-2014
  - Shift of added values to the downstream food-related industries
  - Foodstuff Control Act (1942) replaced by Staple Food Act (1995) shifting from state control of price/quantity/channels to market mechanism
  - Revised Agricultural Land Act enabling PLC's entry in agriculture
- Challenges of globalization
  - JA Group's opposition to trade liberalization of agricultural products
  - Trade liberalization of beef and oranges in 1991
  - GATT Uruguay Round and creation of WTO in 1995
  - Negotiation on Trans-Pacific Partnership (TPP) for further liberalization

# New business challenges in the JA Group

- Shrinking share of agriculture in food related industries

	1970	1975	1980	1985	1990	1995	2000	2005	2010	2011	2012
1st industry	34.6	31.6	24.2	22.8	19.6	14.3	12.5	12.8	12.5	11.9	12.1
2nd industry	29.4	23.7	28.8	26.8	27.1	25.0	27.9	28.7	29.5	29.4	28.8
Investment	2.6	3.3	4.5	3.3	3.7	3.6	2.9	2.1	2.3	1.8	2.0
Distribution	25.5	27.0	28.0	28.5	30.8	37.5	37.5	38.3	36.4	37.0	37.4
Restaurants	7.8	13.8	15.2	18.7	17.8	18.8	19.2	19.1	20.5	19.9	19.6

# New business challenges in the JA Group

- New alliance emerging in food businesses
  - JAs launching food processing and farmers markets
  - Food processors and distributors entering in food production
  - “Agriculture-Commerce-Processing Alliance (ACP)”
  - “The 6th industry linking 1st, 2nd and 3rd industries”
  - JA Group leads alliances both in retailing and processing thru funds.
- Supportive public policies
  - Land Development Council: New measures to promote villages (1900)
  - METI: Industrial cluster plan (2000), Promotion of new alliances (2005), Promotion of utilization of local resources (2007)
  - MAFF: Promotion of food-related industrial clusters (2005), Act to promote the 6th industry (2010)
  - MAFF/METI: Promotion of ACP Alliance (2008)

# New business challenges in the JA Group

- 6<sup>th</sup> Industries in food-related business

	JA and subsidiaries			Other businesses		
	Turnover	No. of entities	Average sales	Turnover	No. of entities	Average sales
Processing	531,840	1,560	341	308,830	29,030	11
Retailing	776,489	10,670	73	126,066	13,030	10

# New business challenges in the JA Group

- Agricultural Co-operative Act was amended in 2015 aiming at increasing competitiveness of agriculture and JAs.
  - Transformation of Zenchu to a general incorporated association
  - Separation of auditing function from Zenchu (JAs can choose newly created JA group's audit firm or other auditors)
  - Enabling changes of legal forms to PLCs or other corporations
  - Governance reform to include more entrepreneurial/professional members in JA's board
  - Limiting use of associate members was not included in this amendment but needs to be examined in 5 years

# Conclusion

- Integration process within JA system needs to be accelerated as a part of JA reforms while larger co-ops need to restructure operations and invest in value added processing/marketing or form strategic alliance with suppliers/distributors.
- Zen-noh is also obliged to implement restructuring to improve governance, lower input price and enhance farmer's income.
- How the JA Group undertakes reforms in business strategy and organizational structure (holding model, Toyota model etc.)?
- Do reforms include the changes in legal forms?