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## The Restructuring of the Saskatchewan Wheat Pool: Overconfidence and Agency

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# The Restructuring of the Saskatchewan Wheat Pool: Overconfidence and Agency

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This paper examines how agency problems combined with overconfidence and hubris by coop management lead to financial failure in the Saskatchewan Wheat Pool. As a consequence of both of these problems, the Pool made poor investment decisions and ended up in severe financial difficulties. These problems were exacerbated by three additional factors: (1) ownership and control were separated via an A-B share structure, leading to a situation where neither farmer members nor investors had an incentive to monitor management activities; (2) the sheer volume of investment activity undertaken made it virtually impossible for the board to stay on top of what was happening; and (3) as a result of the change financial structure, senior management had available a large amount of debt capital that it could spend.

## Introduction

On 30 August 2007, the Saskatchewan Wheat Pool (SWP or Pool) officially became known as Viterra, thereby formally severing all links to its cooperative roots. The real loss of its cooperative structure, however, occurred earlier. A number of dates vie for the honor: April 1996, when Pool shares began trading on the Toronto Stock Exchange, making the cooperative at that time one of but a handful in the world with publicly traded shares; January 2003, when, as part of a massive C\$405 million debt restructuring plan, the number of farmer-member directors was reduced from twelve to eight and four independent directors were added, one of whom was designated as the lead director with responsibility for managing the board; or February 2005, when the SWP's board of directors approved a recapitalization plan that transformed the Pool from a cooperative to a business corporation.

During the period marked by the dates above, the Pool went through a number of major transformations. In the early 1990s, the Pool was the dominant player in the grain handling business in Western Canada, with a market share in its home province of nearly 60 percent and a major voice in Canadian agricultural policy. Through the 1990s, the Pool diversified, investing heavily offshore and in the do-

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mestic grain processing and hog industries, all the while undertaking a massive restructuring of its grain elevator system. By the late 1990s, the Pool had lost a large percentage of its market share, major financial losses were being incurred, and debt was rapidly mounting. In 2000, a new CEO was hired and the company began selling off assets in an effort to stay solvent. After narrowly escaping bankruptcy in January 2003, the company began to turn its financial position around. In late 2006, the Pool announced a takeover bid for Agricore United. The bid was successful and the Pool once again became the dominant player in the Canadian grain-handling industry. In 2009 Viterro moved to become more multinational in scope with a takeover bid for Australia's ABB Grain Ltd.

The purpose of this article is to examine the factors behind the events at SWP in the 1990s. During this period, the Pool's dramatic loss of market share and accumulation of debt placed it on a trajectory that resulted in it eventually losing its cooperative structure. Although the events after this period are fascinating and worthy of study, they are not examined because they are the result of a different set of dynamics driven by the Pool's attempts to deal with problems created during the 1990s. While many forces contributed to the decisions made during the 1990s, this article concentrates on two key factors: the hubris and over-confidence of senior management and a lack of effective oversight by the board of directors.

The rest of this article is structured as follows. The next section provides a brief history of the Canadian grain handling system and the Pool's role within it. The section following that provides details on the Pool's market and financial performance during the mid-1980s to early 2000s timeframe. The article then presents the two conceptual frameworks used in the case study—cognitive theory and agency theory. These frameworks are followed by the presentation of evidence from personal interviews conducted with Pool senior management and elected officials to support the hypothesis that hubris among senior management and a lack of oversight by the board led to poor investment decisions at the Pool. The article concludes with a brief summary and discussion.

## **Overview of SWP and the Canadian Grain Handling System**

Saskatchewan Wheat Pool was one of three “wheat pool” co-ops that formed in the 1920s in Manitoba, Saskatchewan and Alberta to collectively market wheat on behalf of their farmer-members through a jointly owned Central Selling Agency (CSA).<sup>1</sup> Through pooling accounts, each farmer received the same price regardless of the time of year they sold their grain.

The Pools were successful for several years until a poor quality wheat crop in 1928 and falling grain prices beginning in 1929 (which resulted in an overpayment to farmers and mounting margin calls) led the federal government to step in and dis-

solve the CSA (Fowke 1957, p. 248–251). After the dissolution of the CSA, farmers pressured the government to continue grain pooling through a state enterprise, the Canadian Wheat Board (CWB).

With the CWB marketing wheat, the Pools (along with the United Grain Growers (UGG)) operated as farmer-owned grain handling companies. (For further information on the Alberta and Manitoba Pools, and UGG, see Earl 2009.) Although SWP's core business activity was grain handling, it was diversified in other agri-business areas. By the 1990s, the Pool's five operating divisions were: grain handling and marketing; agri-products; agri-food processing; livestock production and marketing; and publishing and other.

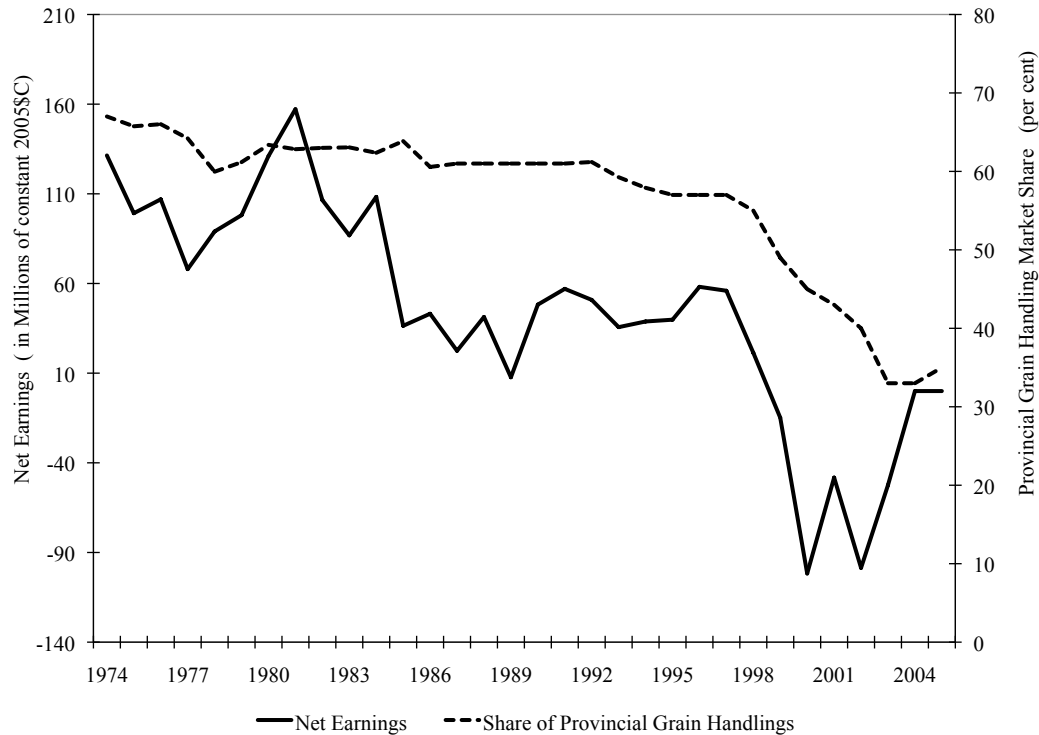
Rail deregulation, trade liberalization and challenges to the CWB prompted a major restructuring of the Canadian grain industry in the 1990s (for more details, see Lang 2006). In 1995, the long-standing subsidy on grain transportation—the Crow Rate—was removed due, in part, to the World Trade Organization (WTO) agreement and a move to cut federal government spending. The railways were allowed to set their freight rates (subject to a revenue cap) and to close branch lines. In reaction to a more liberalized trading environment created by both the WTO agreement and NAFTA, as well as a belief that the CWB might disappear, a number of the multinational grain companies entered the Western Canadian market. In response, the Pools and UGG consolidated their grain handling operations, built large inland terminals on the main lines, and modernized their grain handling systems. The SWP, in particular, began to diversify its operations towards value-added activities.

## **The Share Conversion and Subsequent Events**

As early as the mid-1980s, it was apparent that the Pool was facing a major financial hurdle. With nearly half its membership approaching retirement, the Pool required more than C\$100 million to make patronage equity payouts (Saskatchewan Wheat Pool [SWP] Equity Conversion 1995).<sup>2</sup> That hurdle, coupled with declining net earnings (see figure 1) and the co-op's desire to rebuild its elevator network and to diversify its operations, drove the Pool to consider new financing options. In 1994, delegates approved a dual A-B share structure under which the B shares would trade on the Toronto Stock Exchange.

In the A-B share structure, the Pool used the A shares to leave control in the hands of the farmer membership, and converted retained member equity into tradable B shares. The B shares were viewed as a permanent source of equity (in comparison, traditional member equity is typically considered by banks as debt because it must be repaid to members upon their retirement or exit from farming). With the new financial structure, the problem of redeeming member equity was solved and

**Figure 1. SWP Net Earnings and Grain Handling Market Share in Saskatchewan, 1974–2005**

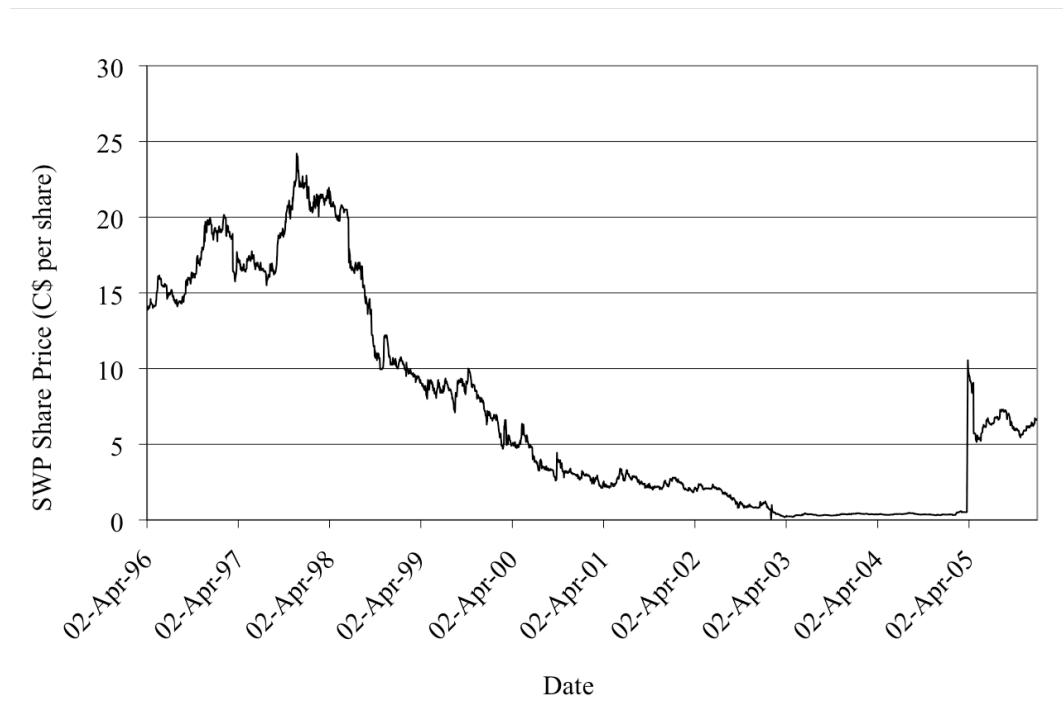


Source: Saskatchewan Wheat Pool Annual Reports

financial institutions greatly expanded the money that they were willing to lend to the Pool for its elevator rebuilding and business expansion programs.

Under the conversion, farmer-members each received one A share worth C\$25. This share gave each farmer-member the right to one vote when electing delegates and the right to participate in Pool committees. The remainder of a farmer's equity was converted to B shares at a rate of C\$12 per share; these shares could then be bought and sold on the Toronto Stock Exchange.<sup>3</sup> Investors were able to purchase B shares up to a maximum of 10 percent of the total issued and outstanding shares, a limit that was intended to keep ownership of the Pool diffuse. An amendment in 2002 allowed for a higher ownership limit to be granted in special circumstances. The ownership limit was removed in 2005 when the Pool became a business corporation.

Trading started on 2 April 1996 with shares opening at C\$12.00. They rose quickly, peaking at C\$24.20 in November 1997, and then steadily declined (see

**Figure 2. Price of Saskatchewan Wheat Pool B Shares on the TSE, 1996–2004**

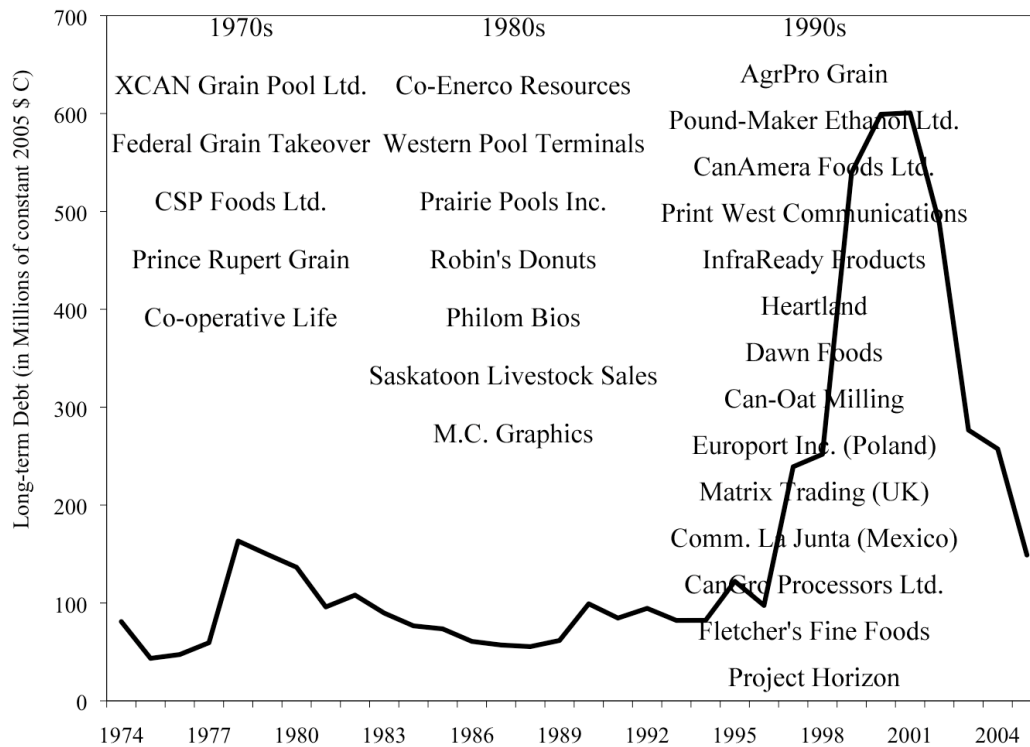
Source: CFMRC TSE Database

figure 2). The share price fell below C\$12.00 in late September 1998 and reached a low of C\$0.18 per share in March 2003.

Although the share conversion did not immediately provide the Pool with access to any more equity capital (a subsequent share offering in 1998 added C\$110 million in equity), the new financial structure meant that financial institutions were willing to make available a significant amount of additional debt capital that the Pool used to pursue new business lines and rebuild its elevator system. Based on the increase in long-term debt that occurred, the Pool likely had access to at least C\$400 million in extra credit.

In 1997, the Pool announced both Project Horizon and its first foreign direct investments. Project Horizon was the Pool's elevator rebuilding initiative, which entailed building twenty-two facilities at a cost of C\$270 million at locations across Saskatchewan, Manitoba, and Alberta. The foreign direct investments included terminal construction in Poland and Mexico, ownership in an England-based trading company, and a joint venture terminal with General Mills in North Dakota.

The Pool also made other investments and acquired other operations. Included among these investments and acquisitions were an oats processing facility, a hog

**Figure 3. SWP Long-Term Debt and Acquisitions by Decade, 1974–2003**

Source: Saskatchewan Wheat Pool Annual Reports

processing facility, a farm input supply business, a number of hog production units, and several food processing businesses. As a result of an unparalleled number of acquisitions and investments (see list of acquisitions by decade in figure 3), long-term debt rose from C\$97.4 million in 1996 to more than C\$539.9 million in 1999 (all figures in 2005\$C) (see figure 3).

In addition to a rising debt, both market share and net income declined sharply (see figure 1). 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. From 1993 to 2003, the SWP's grain handling market share in Saskatchewan fell from 61 percent to 33 percent. As a result of the poor financial showing, both Chief Executive Officer Don Loewen and Chief Operating Officer Bruce Johnson were asked to resign in 1999. A new CEO, Mayo Schmidt, was hired in 2000. Schmidt's efforts to slash debt through massive divestment were unsuccessful. In early 2003, the Pool was forced into a C\$405 million debt restructuring plan and further divestment of major assets.

As the Pool's financial problems grew, it began shedding its co-op identity. The ownership limit on shares was revised in 2002, which opened the door for companies to buy a major position in the Pool. The board makeup went through a series of changes. The first change was the addition of two outside advisors in 1998. The board size was then decreased from sixteen to twelve members in 2000, with two of the twelve board members being external. As part of the 2003 refinancing obligations, the number of external members was increased to four, leaving eight farmer board members. Two years later the Pool became a federal corporation under the Canada Business Corporations Act, which altered the board makeup to seven appointed directors, four elected farmer-board members and the CEO. Legally, the Pool was no longer a co-op. The shares were re-evaluated and traded under the symbol SWP.<sup>4</sup>

As a corporation, the Pool further pared its elevator network to 44 primary elevators in 2006. In late 2006, the Pool entered a bidding war with James Richardson International (JRI) for Agricore United. SWP won the bidding war, with Agricore United accepting the takeover bid in early 2007.<sup>5</sup> The amalgamated company, known as Viterra, is the largest grain handler in Canada, with 30 percent of the primary elevators, 39 percent of the port terminal capacity, and 36 percent of the licensed storage capacity (Canadian Grain Commission 2007).<sup>6</sup> In May 2009, Viterra announced a proposal to purchase ABB Grain Ltd of Australia.

## **Conceptual Framework**

Two conceptual frameworks are used to examine the decisions made by the SWP during the 1990s: cognitive theories of hubris and overconfidence, and agency theory. Both theories provide explanations for why the Pool's investment decisions were unsuccessful. Other factors, of course, were also at work. For instance, a significant drop in member commitment has been identified as an important factor in explaining the poor performance of Project Horizon and the Pool in the late 1990s (Lang & Fulton 2004; see also Lamprinakis 2008). The focus on overconfidence and agency in this article is undertaken to explore more fully these two factors and their interrelationship.

### **Overconfidence and Hubris**

Business executives are generally thought to be overconfident (Brown & Sarma 2007). This over optimism can be linked to selection bias (Gervais, Heaton & Odean 2006), as well as a number of cognitive errors—mistakes in the way that information is processed—that executives routinely make (Lovallo & Kahneman 2003).<sup>7</sup> Among these errors or biases is the propensity for people to overstate their ability—i.e., to see themselves as above average in their abilities and skills. Closely related to

this problem are attribution errors, the inclination that people have to attribute positive outcomes to things that they have done, while attributing negative outcomes to outside events. One of the consequences of these cognitive errors is hubris; managers believe they can do anything, even in situations where others have not succeeded.

Over-optimism in business settings also springs from the manner in which business plans are developed. Most business plans start with a proposal. By their very nature, proposals accentuate the positive. However, starting with a proposal that is tilted towards the positive virtually ensures that the final plan shares the same tilt. The reasoning for this is anchoring, the cognitive tendency to put too much emphasis on initial positions and not enough on subsequent information. Furthermore, information acquired to test the assumptions and claims in the proposal will often be chosen to support the initial beliefs that underlie the proposal, a result of the so-called confirmation bias (Lovallo et al. 2007).

Competitor neglect can also be a source of over-optimism. Business plans developed without considering what competitors are planning can easily result in overcapacity, price wars, or product duplication.

The best evidence for overconfidence and hubris comes from an examination of business acquisitions (Malmendier & Tate 2005; 2008). This evidence is particularly applicable to the SWP given the large number of investments it undertook in the 1990s. The empirical literature shows that firms generally overpay for acquisitions, and that the shareholder wealth of the acquiring firm either falls or remains constant after the takeover.<sup>8</sup>

There are two underlying reasons cited for this overpayment, overconfidence and hubris, and agency problems.<sup>9</sup> Hubris means that CEOs have an overwhelming presumption that their high valuation of a takeover target is correct, even when it is not. Hubris and overconfidence play a particularly important role when considered in conjunction with the investment funds to which a CEO has access. If CEOs have excess cash available, they will tend to invest it in new ventures or acquisitions. As outlined above, CEOs will tend to overpay for these acquisitions, and so the investments will often be unsuccessful.

The relationship between CEO hubris and acquisition premium is greater when board vigilance is lacking—i.e., the less oversight by the board, the greater the overpayment. Indeed, it is widely understood that agency problems can also lead to overpayment and poor investments.

### **Agency theory and oversight**

An agency relationship occurs when a principal hires or appoints an agent to carry out a task on the principal's behalf. Because the principal and the agent differ

in their objectives and because the agent typically has more information than the principal about the environment in which decisions are being made, opportunity exists for the agent to behave in a manner not in the principal's interests (Eisenhardt 1989). This means that the principal has to provide appropriate incentives to the agents to get them to behave in the principal's best interest. In the best-case scenario, the principal's goals are more or less achieved, albeit at a cost. In the worst-case scenario, only the agent's goals are met.

A number of agency relationships exist in agricultural co-ops. In a traditional co-op, the farmer-members are the ultimate principals with the elected board members serving as agents. However, a second agency relationship also exists between the board and the co-op's senior management. This cascade of agency relationships offers substantial room for the agency problem.

Agency theory has been frequently applied to business acquisitions and investments. Jensen (1986) argues that agency problems are likely to be greater in firms that have excess cash available for investment and acquisition purposes. Managers who have access to internal funds do not have to subject themselves to the monitoring that external capital markets provide. As a consequence, they are better able and more likely to make investments that benefit them personally rather than add shareholder value. Accordingly, Jensen argues, firms should ensure that excess cash is paid out to shareholders because doing so results in greater oversight.

Staatz (1987) notes that cooperatives can reach a point in size and complexity that makes it impossible for the board to fully monitor managerial behaviour, regardless of the board members' talents. Quarterly board meetings, which are often the only contact the board has with management, make it difficult, if not impossible, to ascertain if management has exercised proper due diligence on investment proposals. Farmer-elected board members also may not have the knowledge nor business skills that senior managers possess (Ernst and Young Corporate Finance Inc 2002). If board members lack business acumen and simply trust that management provides accurate projections and assumptions, they may end up granting approval to nonviable investments. Thus, if information asymmetry is grouped with board inexperience, an inability to monitor management and an implied trust in management, the agency problem could become quite severe.<sup>10</sup>

In the case of SWP, the agency relationships that existed after the 1996 share conversion were more complicated than those in traditional co-ops. Because the co-op's shares were owned in part by shareholders that were not farmer members, both the farmer members and the class B shareholders could be classified as principals. The board, which was appointed solely by the farmer members, was expected to act as an agent on behalf of both of these groups in its dealings with senior management.

Conceptually, this more complicated agency relationship can be expected to make the agency problem more severe. Because the goals of the farmer members and the investors are likely to differ, and thus some compromise is needed between them, the board and senior management are in a position to claim to both groups that circumstances require that they meet the goals of the other group, all the while undertaking actions that meet only management's goals. And with two groups of principals in place, the incentive to fully monitor the actions of the board and management is likely to be reduced. The result is that the board and management may have more leeway to pursue their own objectives.

In summary, co-ops that are large and diversified, are publicly traded, have highly confident leaders, and have excess internal funds available for investment are likely to be at greatest risk of overinvesting and having investments turn out poorly. SWP possessed all these characteristics, and the result, at least in retrospect, was predictable—the investments made by SWP in the 1990s were largely unsuccessful.

## **Analysis**

This section uses evidence collected from published material and 21 personal interviews conducted with former SWP management and board members to illustrate how overconfidence and hubris resulted in a number of poor investments, which resulted in the Pool losing customers and incurring an ever-increasing debt. Further analysis of these interviews, conducted from September 2004 to April 2005, as well as additional details on the quotes presented below, can be found in Lang (2006).

### **Overconfidence and Hubris**

From 1996 to 1999, the Pool invested in approximately 25 acquisitions and long-term debt grew five-fold. This spending stemmed from a belief of urgency. The Pool believed that it needed to “move rapidly to beat [the] U.S.” and it needed to “become more of a global player and expand beyond Saskatchewan borders.” There was a conviction that if the Pool did not “stay at a significant size. . . [it would] become one of two things: irrelevant or sucked up.” Interviewees recalled how Pool management and board members arrogantly believed the Pool could become “the ConAgra of the North” and become “one of four or five top grain companies in the world.” 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” (Casey 1997).

The 1996 share conversion, by enabling access to greater debt, provided the capital for rapid expansion. As one interviewee described it, the Pool felt like it had

a “bottomless pit of money.” With the “capital from the public markets, not only could [the Pool] make a lot of decisions quickly, they felt they were expected to.”

A sense of confidence permeated the board and management. The Pool believed it was “well positioned for the changes rapidly transforming the once highly regulated and stable industry” (1997 SWP Annual Report, p. 14). Other grain industry participants expressed confidence in the Pool as well, which, in turn, served to validate management and board members’ beliefs. 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). 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 western agricultural industry, . . . policy analysts might use their time and resources most wisely if they simply talked to three companies: SWP, Cargill and . . . Monsanto.” (Loyns, Knutson, & Meilke 1998, p. 149).

Loewen was seen as the right individual for the job. Investments that he had orchestrated—specifically Robin’s Donuts and CSP Foods—had turned out well for the Pool, so the board “didn’t think he could do anything wrong.” One board member explained that Loewen was hired because “he was [the] type of individual who moved fast” and the board knew it had to “keep the reins on this individual because he [would] be very aggressive.”

Loewen was “absolutely driven by the thought that [the Pool] had to move very quickly.” He had everybody “hooked on this idea of being the biggest and the best.” 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 [the Pool] couldn’t be stopped.” Loewen’s power and leadership style was reflected in the investment decision-making. An interviewee described Loewen’s decision-making as “shoot from the hip” based on good gut feelings.

The need to move quickly to diversify and invest affected the analysis and the decision-making process. “Ideas did not get . . . proper and adequate evaluation, if Loewen wanted to do it everyone would find a way to make it happen.” As one board member explained “the argument that was being made was that if [the Pool] did it first, no matter what we paid for it, we would prevent our competition from doing it and then we would be successful.”

Some interviewees were of the opinion that people “in very senior operational positions [had] no outside experience” and “the board did not have the makeup or people on it . . . that would occur in a company somewhere else.” One management employee used the words “naïveté and arrogance” to describe the corporate culture. The Pool was considered to be lacking the experience and background in its management and board to say, “No, this doesn’t make sense.”

The quotes and examples presented above provide evidence of significant overconfidence and hubris by the senior management and board. This overconfidence and hubris appears to have stemmed from a number of cognitive errors. Senior management, along with the rest of the organization, clearly saw itself as above average in business acumen. Success was believed to have stemmed from the actions and decisions that management made, rather than due to outside events or good fortune. Anchoring and the confirmation bias were both at work—business proposals and investment analyses were constructed to be optimistic, which in turn appears to have bred further optimism. Finally, competitor neglect seems to have been important. Because the Pool felt it could keep out competitors if it moved quickly, the decisions of these competitors were almost certainly not being considered (see the next section for additional examples).

When the overconfidence and hubris were combined with easy access to additional debt capital, the result was a major spending spree. And this spending extravaganza was indirectly encouraged by an apparent unwillingness and/or inability of the board to question and challenge the expenditures being made.

### **Lack of Oversight**

The lack of oversight and its connection to an agency problem at the SWP is best captured by a former employee:

I think after that, in the 80s and 90s, that is when the quintessential struggle between the board and management started. This is an issue for every organization that has boards, whether appointed, elected, . . . you have the board and then have your senior management. Senior management is always in a better position information wise, the management staff were usually higher-trained educated people with all sorts of skills, everything from being able to do social research to accounting to all those things. . . . You could see the gradual change where the board became almost dependent as opposed to being the final decision-making body. They basically became dependent on management to tell them, 'Here's what you should do and here's why you should do it.' At the board level there probably wasn't the capability . . . but in terms of being able to make some of these major decisions around [Project Horizon], they pretty much had no choice but to go with what management put before them and as best as they could make decisions on it.

The relatively complex agency relationships that existed in the Pool after the conversion greatly influenced the decisions that were made. For the most part, senior management was able to bring the board on side with respect to its view of the

SWP's future path. All interviewees agreed that, given the deregulation occurring in the 1980s and early 1990s, the grain industry was evolving into a new system with new players. They also agreed that the Pool had a strategy to remain a dominant player, although to achieve this goal they would have to move quickly. A senior manager recalled that "as all the regulations fell away from the grain side [the Pool] simply had no choice but to become much more market-driven and market influenced." A diversification strategy was so important that both the board and management believed that the Pool would not survive if it did not diversify.

The acceptance of management's vision likely reduced the board's incentive to monitor management's actions. The investments and activities proposed by the Pool were clearly associated with a diversification strategy, and the agreed upon need to move quickly meant that the board's ability to hold up investment decisions for sober second thought and analysis was greatly reduced.

There was also no strong incentive for either of the two main principals—farmers and investors—to monitor the actions of their agent, namely the board. Patronage payments ended with the share conversion, so farmers lost their incentive to ensure that investments were properly undertaken. And because investors (the B share owners) could not vote, and therefore could not influence the board, they too lacked an incentive to monitor the decisions being made. This lack of incentive from both principals was likely a contributing factor in why the board failed in its oversight role.

Other factors, however, were also at work. The "need for confidentiality increased when [the Pool] went to a share offering." The Pool had to become less specific about where it had business interests because of the risk of insider trading. This lack of information sharing was part of a larger pattern observed by board members. 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."

Senior management, however, saw the situation differently. As senior managers remarked, "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." In a similar vein, the comment was made that, "[t]he 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." At the same time, "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. 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."

As the Pool expanded, it became increasingly difficult for board members to provide expertise. 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.” 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.”

### **Overconfidence and Lack of Oversight – Impact on Investment Decisions**

To further understand how overconfidence and lack of oversight affected investment decisions, this section examines three investments that were mentioned during nearly every interview: (1) Project Horizon; (2) Humboldt Flour Mills; and (3) the foreign direct investments.

Project Horizon began with an announcement of the location of all twenty-two elevators. Construction also began more or less simultaneously on all the high throughput elevators. 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.” This “move quickly” approach did not work. Board members were astonished that companies would build facilities just a few miles down the road from a SWP high throughput location. The competition’s 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.”

The revenue shortfall was also likely a result of falling member commitment. As Lang and Fulton (2004) argue, member commitment fell, in part, because the members no longer saw the Pool as operating in their best interest. This belief was partially a consequence of the investment activities pursued by the Pool and the manner in which they were carried out, as the example of Humboldt Flour Mills shows.

Even though Humboldt Flour Mills was not the Pool’s largest investment, it “was the bellwether that told everybody else in rural Saskatchewan [that the Pool] was out of control.” One senior manager described the 1998 acquisition of Humboldt Flour Mills as “a bidding war with Agricore.” When Alberta Wheat Pool expressed interest in the company, the Pool “didn’t want Alberta Wheat Pool in farm supplies in innermost Saskatchewan,” so the Pool “ended [up] paying C\$16 million for Humboldt Flour Mills.” A range of managers and board members saw the acquisition as “keep[ing] Agricore out” even if that meant paying “far more than what made economic sense.”

On the foreign investment side, the Pool made investments in grain handling terminals in Poland and Mexico in 1997, and in a grain-marketing firm in England in 1998. All of these investments were unsuccessful. Interviewees lay part of the blame for these failed investments on “unscrupulous partners” and data from a consulting company that “did not come to fruition.” There were interviewees who partly blame the Pool because these were areas where the Pool had no traditional operating knowledge. One board member was highly critical of the terminal investments: “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.”

These examples further illustrate the underlying errors that were made in the analysis of investment projects, the over-optimism that was present in the organization, and of the lack of effective oversight. Anchoring, the confirmation bias, and competitor neglect were present. Hubris was also a factor—management had a belief they could make investments in virtually any area, regardless of whether they had any experience.

## **Discussion and Conclusions**

Looking back at what transpired at SWP in the 1990s, it is not surprising that the investments made during this period were largely unsuccessful. Both agency problems and overconfident leaders were present in the Pool. The agency problem was exacerbated by three factors: (1) ownership and control were separated via the A-B share structure, leading to a situation where neither the farmer members nor the investors had an incentive to carefully monitor the activities of the CEO and senior management; (2) the sheer volume of the investment and acquisition activity that was undertaken made it virtually impossible for a board to stay on top of what was happening; and (3) as a result of the change in financial structure, the senior management had available to it a large amount of debt capital. This easy access to funds also exacerbated the overconfidence and hubris that the CEO and senior management exhibited—new investments could be undertaken without being subjected to the scrutiny of the capital market.

In short, SWP succumbed to the two classic problems associated with financial investment activity, agency problems and management overconfidence. The result was as expected—the Pool overinvested and made poor investments, the consequence of which was that its financial viability was severely challenged. What started as an attempt to keep the SWP competitive in a rapidly changing market ended with SWP making bad business decisions, which in turn resulted in the loss of the Pool’s cooperative structure.

What lessons does the SWP case provide to other cooperatives? Given their relatively complex agency problems, cooperatives must ensure that someone has an incentive to oversee the board. In traditional co-ops, the members often play this role. If members become less connected to the cooperative—perhaps because of increased size or increased variety of activities—it is important that the board remains independent and accountable. This point is particularly important if the sources of financing for the co-op become increasingly diverse, which in turn means that the incentive for any group to monitor the actions of senior management is reduced.

Oversight by the board is also important. Agriculture co-ops must ensure that board members have the necessary support and skills to undertake their fiduciary responsibilities. Many co-ops have changed their board makeup to include appointed members with specialized knowledge and expertise in the fields of finance, marketing, and accounting. It makes sense to provide finance and management training courses for the board to ensure that they can analyze projections and assumptions behind the decisions being made. A board with strong knowledge and business skills will help alleviate the risk of information asymmetry.

These suggestions are means of dealing with the long understood problem of information asymmetry. The case presented in this article suggests that cognitive asymmetry is also important. It is critical that a board find ways of getting at the cognitive errors that they and their senior management are likely to make. There are ways, for instance, of dealing with overconfidence and the cognitive errors that underpin it, and cooperative boards need to embrace these techniques. One technique that has been suggested is the use of reference classes, a set of analogous situations to which the current decision can be compared. This technique can be combined with a process that explicitly accounts for bias (Lovallo & Kahneman 2003). While boards should not be expected to actually carry out an analysis of proposals using this technique, they can ensure that it or something similar is used as a part of all decision-making. A board, for instance, could establish a policy whereby it would not approve a proposal without a report on the results of such exercises.

In summary, cooperatives are likely to face an increasing number of governance problems as they adapt to rapidly changing economic environments and adopt increasingly complex forms of financing. As the SWP example illustrates, problems of agency and cognition can be particularly troublesome for cooperatives. Special attention to these problems will be necessary if cooperatives are to retain their cooperative nature.

## Notes

1. See Fowke (1957) for a history of the Prairie grain industry from 1900–1950. For a history of the Saskatchewan Wheat Pool prior to the 1980s, see Fairbairn (1984).
2. While the Pool was under no legal obligation to repay member equity, there was a strong expectation by the membership that repayment would occur.
3. A trading period prior to the share opening allowed farmers to trade shares amongst each other. At the start of trading on April 2, 1996 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 1996).
4. As a publicly traded cooperative from 1996 to 2005, the SWP's ticker symbol was SWP.B.
5. For an examination of Agricore United's decision to accept the Pool's takeover bid, see Earl (2009).
6. To satisfy the federal Competition Bureau, the Pool and Agricore United were required to turn over ownership of 24 elevators and nine farm service centres to JRI and Cargill (Ewins 2007a). Without this turnover, Viterra would have controlled 68% of the licensed storage capacity in Western Canada (Ewins 2007b).
7. In explaining the role of overconfidence and hubris on business strategy, Lovallo & Kahneman (2003) are followed closely.
8. Using evidence from 1973–1998, Andrade, Mitchell, and Stafford (2001) present evidence that the stock value of the acquiring firm falls with an acquisition, although this result is not statistically significant at the five percent level. A review of numerous earlier studies is also provided in this paper.
9. See Brown and Sarma (2007). Roll (1986) was one of the first to demonstrate that hubris is responsible for overbidding. Heaton (2002) discusses the interaction of optimism and excess cash on investment decisions. Hayward and Hambrick (1997) conclude that the relationship between CEO hubris and acquisition premium is greater when board vigilance is lacking.
10. The problem is argued to be particularly acute in cooperatives because they lack a publicly traded share that serves as an indicator of financial health (Cook 1995; Vitaliano 1983). A test of the agency problem in agricultural cooperatives using the Jensen (1986) framework is presented in Featherstone and Al-Kheraiji (1995) and Hailu (2005).

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