The use of the results as capitalization strategy of agricultural co-operatives in Paraná

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Abstract

With significant importance in the economic background in Parana, the agricultural cooperatives grow each year seeking better results for its members. Throughout their history, several difficulties were found in their development, since a great amount of investment has been necessary to support their practices throughout the years, directly affecting their capital structure. Hence, looking for better capitalization mechanisms has become a challenge for most coops in Parana. The aim of this paper is to verify if the co-operatives in the state use their annual results as a way of capitalization and how much of the result is given back to their members. We used secondary data and general meetings records in a non-probabilistic sample of the 15 biggest co-operatives in the state. We used income criteria based on the 2014 data, we verified that 65% of the total income is addressed to mandatory legal funds and funds created for the cooperatives development and capitalization, moreover, 4% were allocated to the members’ social capital’s share and finally 30% are given back to their members in the form of financial resources, proving the use of surpluses as a capitalization strategy of the cooperatives. Briefly, this assessment sought to contribute to the discussion about cooperative capitalization, demonstrating the importance of generating positive results and its influence on the capitalization strategy.

Keywords: Capitalization. Agricultural co-operatives. Surpluses allocation.

Introduction

Cooperativism is described as a democratic participation of the people, where everyone has the same rights and obligations, regardless of the capital invested. It is
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defined by the International Co-operative Alliance as an “association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise”. (ICA, 2015)

Worldwide, around one billion people belong to a co-operative (WORLDWATCH INSTITUTE, 2012). Due to its relevance to the global context, The United Nations (UN) have declared 2012 as the International Year of the Co-operatives, with the purpose of promoting growth in the sector and contributing for worldwide socio-economic development.

In Brazil, of all fields that take part of the cooperative movement, the agricultural is one of the most important and representative, and according to the data from OCB (2015) it is made up of 1,600 co-operatives that gather more than one million members generating more than 164 million direct jobs. The countryside in Parana is one of the greatest economic forces for the state’s regional development. There are 74 agricultural co-operatives are affiliated with the State Organization of Cooperatives, which are made up of 139 thousand members who had revenues of R$ 42.2 million (Brazilian reais) in 2014. These co-operatives represent 55% of the agricultural economy in Parana, they also actively take part in the process of production, beneficiation, storage and industrialization of most of the agricultural products produced in the state. (PARANÁ COOPERATIVO, 2015)

During the development of the agricultural co-operatives, they have faced many challenges throughout the last decades. The various economic crises, climate issues, currency and agricultural production problems posed great challenges for the cooperative system. Besides that, for co-operatives to grow, it was necessary to invest in the expansion of their facilities, as well as the industrialization of the agricultural production and its diversification, aiming to add value to the farmer-members. That is, co-operatives would have to reconsider their strategies in order to maintain their activities.

When Cook (1995) approached the complex organizational structure of the agricultural co-operatives, he identified some problems related to disincentive for the co-operatives capitalization, which directly affects their capital structure, generating more bank loans dependency. Zeuli and Cropp (2004) emphasize that those co-operatives need proper capital structure to function efficiently and grow. It is vital for daily operations, supporting business volume. Therefore, capitalization is very important in these organizations in order to adjust their capital structure to achieve progress in their activities.

As a result, this article aims to verify the allocation of results in agricultural co-operatives in Parana in recent years and, if there is capitalization of surplus income. That is, do the results achieved by the co-operatives work as a capitalization strategy?

Literature Review

The researches in the finance and strategy fields have many connections. For Kochhar (1998), there is a reciprocal relationship between a firm’s financial strategy and its corporate diversification strategy, that is, there are influences occurring in
both areas which are part of the development of the organization. Still, strategy and finance are growing together and integration between them can be a competitive mechanism.

Grant (1991) reinforces this statement, since he believes resources are the source of a firm’s capabilities. Capabilities are the main source of its competitive advantage. And that’s why strategy shouldn’t only explore resources of available capabilities, but as well replace and increase the resource base and the firm’s capability to protect and expand the source of its competitive advantage.

For this reason, capitalization is a key issue for the firm’s development. Bi­aloskorski Neto (2012) highlights that the formation of a company happens in situations where there is an early lack of capital production and he reinforces that the capital must be generated by the firm and redirected to its growth, making it look like a collective capital for the firm.

So, co-operatives will not have, then, an autonomous and independent existence from their members, as in companies. Rather, they exist as intermediate economic organizations in order to provide services to their members by meeting their individual needs (BIALOSKORSKI NETO, 2012).

Lazzarini et al. (1999) apud Bialoskorski Neto (2012), show that, “financial decisions in co-operatives are particularly complex, since the definition of an optimal capital structure, with regard to debt (third party capital) to assets (equity capital) ratio as alternatives sources of resources, it is difficult to implement”.

This is also due to distinctive feature related to the capitalization of those firms, since they are self-managed firms, made of their member’s shares without seeking profit in their operations, they depend on third party capital since the beginning of their growth process. Besides that, the co-operatives end up sponsoring their members in order to ensure the purchase of certain amount of commodities and, or, inputs sale, requiring an increased need for resources to operate (BIALOSKORSKI NETO, 2012).

Mills and Davies (2013) also emphasize this situation, claiming that the benefits which are not shared take time to accumulate and they are not available at the initial stage of its activities. In addition, in many legal systems the co-operatives are, therefore, faced with capital access challenge.

It occurs in Brazil, since the share does not present trading in aftermarket and the surpluses are shared according to the member contribution. The greatest challenges, however, arise from the need to find alternatives to obtain own funds, making it possible for the co-operative to grow having their core doctrinal principals respected (BIALOSKORSKI NETO, 1998).

The act 5.764/71, which regulates the co-operatives, brought about some considerations regarding to the development of funds and reserves on article 28, stating that:

Art. 28. The co-operative must establish:

   I – Reserve funds intended to repair losses and support the development of their activities, made up of 10% (ten percent), at least, of net surplus.

   II – Technical Assistance Reserve, educational and social, intended to provide assistance to members and their family and,
when provided in the statute, to their employees, made up of 5% (five percent), at least, of net surplus.

§ 1° In addition to those provided in this article, a General Meeting can create other funds, including revolving funds addressed to particular purposes establishing standards of training, implementation and liquidation.

That is, all co-operatives must establish, since their incorporation, a reserve fund which will take at least 10% of net surplus and funds for Technical, Educational and Social Assistance, which will take at least 5% of net surplus. The co-operatives can raise those percentages and also establish other funds, according to their needs. These options allow the co-operative to have an established source of resource for projects and growth. Thus, the co-operative can hold a solid resource base for their capitalization.

Mills and Davies (2013) support the idea that businesses cannot function without capital, as well as co-operatives. And there are two main sources of capitalization, the social capital which is paid up by the shareholders as they join the co-operative and the funds which are made up of results, according to social bylaws and meeting decision.

Gimenes (2004) assures that a new world economic scene is presented to the co-operatives as a permanent conflict, which maintains a competitive company, able to deal with large multinationals and, simultaneously, meet their member’s needs, not always with great results. That conflict sets limits to their expansion process funding, with own resources (self-funding), especially in developing economies in which the capital is usually scarce and high.

In the context experienced by the co-operatives, capital structure is an important aspect, since there are limitations on capital injection, forced to fall back upon debts in order to finance their growth. For that reason, it comes the importance of correctly use their results in order to continue with their venture (BIALOSKORSKI NETO, 2002).

Historically, it is noticed on a statement by Gimenes and Gimenes (2008), that agricultural co-operatives in Brazil face great challenges for their development, since trade openness and bitter competition with foreign products brought problems to guarantee raw products in order to maintain their activities, since the competition became more and more severe also for the selection and farmers loyalty. In addition, some agricultural co-operatives started to execute credit operations with their members, taking growing risks with financial institutions, especially during harvest recession.

From the 1980’s, as trade margins of “in natura” products started to reduce, the operational process begins to require professionalization in the co-operatives and their constant need for improvement in the processes, that is, move from mere trading to agribusiness, involving management of co-operatives and their members. The big paradigm was the need for capital injection, of their own or third parties, in order to build new industrial facilities, foster new activities, process and trade industrial products.
This scenario resulted in a significant increase of the co-operatives’ debts and a high fixed asset with low profitability, that is, with scarce own resources, high interest rates for loans and highly indebted, especially in the 1990’s.

However, if we look at the situation of Parana in particular, we notice several co-operatives that present great importance for the regional economic context. According to Ocepar (2010), the dynamism of the agriculture in Parana can be awarded to the colonization strategy in the state, as it was developed based on working and trusting relationships, since the European communities which settled around here were seeking personal development. And it reinforces that in Parana context, the cooperativism stands out as an instrument of social mobility for their members and also promotion and regional development based on agribusiness chains of great competitiveness.

For this reason, financing decisions walk side by side with investment decisions, that is, the companies need enough resources to support the activities generated by the investment decisions (BAKER; MARTIN, 2011). The source of resource, of their own or third parties is associated with different levels of risk, benefits and control (LA ROCCA, 2011).

According to Proner and Costa (2005), the need for the co-operatives capitalization lead many managers to suggest the destination of surpluses to indivisible funds and reserves, generating a relationship between social capital and net assets steadily falling. Since the co-operative needs resources to support new investments and their members do not get motivated to do so, since the profit is not proportional to their capital, the most played solution is the capitalization of part of the results.

It is in this context that we observe this form of capitalization, researching the decisions that were taken in the recent years with regard to the allocation of the annual surpluses of the co-operatives in Parana and what it represented in terms of capitalization strategy.

**Methodology**

This research was split in two stages, at first a textual analysis was performed with general data of the agricultural cooperativism in the state, using data from secondary sources obtained from a monitoring program of the co-operatives in Parana, through the Ocepar System (Organization of the Cooperatives in Parana). Secondly, it was performed a desk research of the meeting minutes of the co-operatives part of the sample, to check the results achieved in the 2011, 2012, 2013 and 2014’s and their allocations.

The population of this research covers all agricultural co-operatives in Parana, affiliated to Ocepar in 2004, representing 74 co-operatives, however, aiming to refine and enable the research, a non-probabilistic sample was determined, comprising the 15 largest co-operatives in Parana, taking as criteria the income obtained in 2014 and as a result the selected co-operatives were: Agraria de Guarapuava, C.Vale de Palotina, Capal de Arapoti, Castrolanda de Castro, Coamo de Campo Mourão, Coasul de São João, Cocamar de Maringá, Cocari de Mandaguari, Coopavel de Cascavel, Copacol de Cafielandia, Copagril de Marechal Cândido Rondon, Frimesa de Medianeira,
Frísia de Carambeí, Integrada de Londrina, and Lar de Medianeira which together represent 85.5% of the total turnover of the field.

After checking secondary data, a desk analysis of the general meeting minutes of 2011, 2012, 2013 and 2014 was conducted on the co-operatives part of the sample. The aim was to demonstrate which were the allocations of the obtained results achieved by the co-operatives in those years to understand which ratio of the results return to their members, under legal possibility, to their social capital or if they are capitalized in specific funds, chosen at the meeting.

**Results**

Responsible for 55% of the agricultural production in the state, the agricultural cooperativism in Paraná, affiliated to Ocepar System, is made up of around 140 thousand members, which 77% of these own less than 50 hectares of land, that is, most of the members are considered smallholders farmers. Those co-operatives are responsible for 38% of the agribusiness in Paraná, with 48% of the income generated in 2014, R$ 42 billion (Brazilian Real), coming from products with added value, which means, products that have undergone a process of transforming (OCEPAR, 2015).

From data obtained for the analysis, the equity capital presented on figure 1 was broken down into social capital, reserves and returns, and also presented a development during the analysis, going from R$ 8.3 billion in 2011 to R$ 12.4 billion in 2014, which represents 36% of the assets of those companies.

**Equity Capital (R$)**

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Results</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reserves</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social Capital</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Figure 1** – Equity Capital Development of the Agricultural Co-operatives in Paraná

Source: Search Data, 2016.

It is important to highlight the greatest allocation of reserves on equity capital, according to Proner and Costa’s (2005) approach, where during the last period, the reserves represent 72% of equity capital.
Deepening the analysis of equity capital, a desk analysis of general meeting minutes of the 15 largest agricultural co-operatives in Parana was conducted. In order to justify its relevance, table 1 shows the co-operatives main financial statements for the year 2014, compared to the selected sample data to prove its representation before the whole. It’s important to highlight that the establishment of the sample came about through the revenues index which represents the total income of the co-operatives in the year.

Table 1 – Comparative: Agricultural Co-operatives PR x Sample

<table>
<thead>
<tr>
<th>Year 2014</th>
<th>Agricultural Co-operatives PR</th>
<th>Co-operatives Sample (15 largest)</th>
<th>% Representation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues (R$ thousand)</td>
<td>42,216,947</td>
<td>36,745,037</td>
<td>87.0%</td>
</tr>
<tr>
<td>Net Assets (R$ thousand)</td>
<td>12,444,763</td>
<td>10,898,467</td>
<td>87.6%</td>
</tr>
<tr>
<td>Social Capital (R$ thousand)</td>
<td>1,809,922</td>
<td>1,400,901</td>
<td>77.4%</td>
</tr>
<tr>
<td>Surplus before Allocation (R$ thousand)</td>
<td>1,693,494</td>
<td>1,541,759</td>
<td>91.0%</td>
</tr>
<tr>
<td>Number of members</td>
<td>144,245</td>
<td>104,277</td>
<td>72.3%</td>
</tr>
<tr>
<td>Number of Employees</td>
<td>67,937</td>
<td>56,158</td>
<td>82.7%</td>
</tr>
</tbody>
</table>

Source: Ocepar, 2016.

It can be seen on chart 1 that the co-operatives on the sample represent in terms of revenues, that is, total financial transactions, 87% of the total, R$ 36.7 billion. Besides that, the net assets which is made up of capital social, reserves and results in that period represents R$ 10.9 billion which means 87.6% of the total of the population.

However the social capital of the sample, which is made up of paid up members as they join the co-operatives, which can be bolstered as well by meetings allocation of part of the results reached at the period, or even of capitalization rates in operations, reached R$ 1.4 billion and represents 14.5% of the total net assets, implying great number of reserves already incorporated in those companies.

Surpluses were also taken to the research, which before the allocations were R$ 1.5 billion, in the sample, representing 91% of the results of the agricultural co-operatives in Parana, that is, a significant participation of the great co-operative in this aspect. In addition, the number of members and employees was also presented, having reached in 2014, 104 thousand and 56 thousand, respectively.

After proving how important the sample is for the research, looking at its data, it can be noticed on table 2, the records of the results achieved from 2011 to 2014, so then it is possible to examine its impacts.
Before Table 2, it is possible to notice growth in the results achieved by the co-operatives of the sample, being the percentage change 100% from 2011 to 2014, being 22% in the last period, reflecting the good results achieved by those companies during the analysis and their growth.

Before the results become available to the Ordinary General Meeting, the mandatory allocations are made, and include, according to the law, Reserve Funds, with at least 10% of surpluses, and Funds for Technical, Educational and Social Assistance, with at least 5% of the surpluses. Furthermore, the law establishes that results of operations with third parties, that is, results of operation with non-members must all be allocated to Funds for Technical, Educational and Social Assistance, in conformity with the article 87 of Law n. 5.764/1971: the results of the co-operatives operations with non-members, as mentioned on art. 85 and 86 will be taken to Funds for Technical, Educational and Social Assistance and they will be booked separately, in order to allow taxes calculations.

Thus, it can be noticed on table 3, how much was allocated to mandatory accounts, highlighting that most of the co-operatives made changes in their bylaws aiming to increase allocations to mandatory funds. In addition, many set up mandatory statutory funds, which will be looked at as follows.

<table>
<thead>
<tr>
<th>Year</th>
<th>2011</th>
<th>%</th>
<th>2012</th>
<th>%</th>
<th>2013</th>
<th>%</th>
<th>2014</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Surpluses before Allocations</td>
<td>771,544</td>
<td>100.0%</td>
<td>1,003,796</td>
<td>100.0%</td>
<td>1,265,174</td>
<td>100.0%</td>
<td>1,541,759</td>
<td>100.0%</td>
</tr>
<tr>
<td>Allocation for Funds for Technical, Educational and Social Assistance</td>
<td>93,678</td>
<td>12.1%</td>
<td>169,711</td>
<td>16.9%</td>
<td>142,674</td>
<td>11.3%</td>
<td>302,798</td>
<td>19.6%</td>
</tr>
<tr>
<td>Allocation for Reserve Funds</td>
<td>106,112</td>
<td>13.8%</td>
<td>156,125</td>
<td>15.6%</td>
<td>241,819</td>
<td>19.1%</td>
<td>260,497</td>
<td>16.9%</td>
</tr>
</tbody>
</table>

Source: authors, 2016.

With regard to the allocation for Funds for Technical, Educational and Social Assistance, it can be noticed in most of the minutes that there was no changes in the mandatory minimum percentage, but the main contributing factor for the increase on
the allocation were the results of third parties operations, raising the allocation percentage, especially in 2014, having allocated R$ 303 million to this accounting record. With regard to the allocation for Reserve Funds, it was possible to notice that went from 10%, the mandatory minimum, to 15% or 20%, increasing the reserve which aims to cover future losses and also generate cash flow. However, as the co-operative’s management is becoming more professional and the results are being followed up every month, many co-operatives do not generate loses, so, this funds also become a source of capitalization.

After mandatory allocations, the balance become available to the general meeting so it can be allocated. Table 4 shows allocations performed from 2001 to 2014, which is the main purpose of this study. It is important to reinforce that part of the allocations had already been done before becoming available to the general meeting and can vary from co-operative to co-operative according to its own bylaws, adopted by their members.

<table>
<thead>
<tr>
<th>Table 4 – Results of Allocations Cooperatives Sample (R$ thousand)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Year</strong></td>
</tr>
<tr>
<td>Surpluses before Allocation</td>
</tr>
<tr>
<td>Surpluses Available to Meetings</td>
</tr>
<tr>
<td>Development Fund Allocations</td>
</tr>
<tr>
<td>Capitalization Fund Allocation</td>
</tr>
<tr>
<td>Interest on Capital</td>
</tr>
<tr>
<td>Paid up Capital</td>
</tr>
<tr>
<td>Member’s Equity</td>
</tr>
</tbody>
</table>

Source: authors, 2016.

After looking at the minute meetings, it was noticed that most of the co-operatives established at least two funds for the results allocation, of which most of them have already established in statute, minimum percentage that will be allocated for these funds. Although with different names, the main objective of these funds was either development and growth of the co-operative or capitalization. For this reason they were called: Development Funds Allocation and Capitalization Fund Allocation, covering these records.

In addition, some co-operatives, however fewer, establish the interest on capital payment, permitted by law at the highest rate of 12% per year. However, the small number of co-operatives that practice this policy pay on average, 6% each year
of the members capital. Some co-operatives also suggest their members to incorporate the incomes to the social capital, which is an arrangement of capitalization that help both sides, that is, the co-operative, being a resource that is found on the net equity of the company and also supports the member, when disassociate from the co-operative can easily withdraw the balance. Finally, the member equity is performed in all co-operatives of the sample. 

The results obtained in the three years of research were very close, showing that the co-operatives, for some time, have been performing this allocation policy. It can be seen on table 4 that surpluses available to meetings, which could be 85%, the least permitted by law, remain on an average of 70%, due to the increase of Reserve Funds and Operations with third parties, as seen on table 3. After that, the co-operatives established other indivisible funds aiming to gather own resources to their development and capitalization, being, on average, 30% of the surpluses for development funds and 4.8% for capitalization, summing up 35% of the income achieved to other funds created for the cooperatives, in order to obtain own resources for their development.

After allocation of funds, the co-operatives which established interest on capital policy, allocated an average of 1% of the results for this matter. The ones which decided to incorporate part of the results to the social capital allocated an average of 2.8% during the 4 years of research, showing that only a small share of the results is allocated to equity capital. Thus, the allocation of the results for funds and social capital sums up an average of 69% of surpluses, which supports the capitalization of those companies. 

So, part of the result given back to the members according to the sample was 32.2% in 2011, 28.1% in 2012 and 32.1% in 2013 and 27.7% in 2014, average of 30% on the analysis. That is, the possibility of the allocation straight to the member’s pocket is up to 85% of the income, being the mandatory funds already deducted, however, it was verified through this study that the average given back to the members was 30% on the established sample of the agricultural co-operatives in Parana. This percentage represents a sum of about R$ 1.36 million given back to the agricultural co-operatives of the sample, that is, more resources for the members to invest in their activities, numbers that represent one of the greatest differential of Cooperativism.

Thus, it is proved that results generated annually by the co-operatives in Parana as capitalization strategy, being most of the surpluses, 65%, are taken back to the cooperative’s statutory funds ad 4% allocated to their member’s social capital and 30% are given back as return of resource to their members.

Conclusion

Aiming to demonstrate the behavior of the result allocation of the Parana state agricultural line of work and to analyze how much of that result returns to co-operative members as financial resources, this paper handled secondary data and desk analysis of ordinary general meetings minutes, in order to verify that most of the results reached by the co-operatives is destined to specific funds that have as
objectives their development and capitalization, which proves that the annual results are used as capitalization strategies by the agricultural co-operatives of Parana.

The results of such analysis showed that, in average, 30% of the result is returned to the co-operative members as direct resources and 4% is returned to the social capital directly or as interest over the capital. Finally, most of the result is destined to indivisible funds, being that 35% of the results is destined to the development and capitalization funds created by the co-operatives and 30% is destined to the mandatory funds required by law, which are the Legal Reserve Fund and the Fund for Technical, Educational and Social Assistance. Numbering then, 65% of the result for indivisible funds that will aid the capitalization of agricultural co-operatives and their development.

Finally, this analysis looked to contribute with the discussion regarding the surpluses allocation presented by the agricultural co-operatives, demonstrating that the reached results are indeed a capitalization strategy of such co-operatives and help supporting the growth and development of these organizations.

References


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