Agroholdings, turbulence, and resilience: The case of Ukraine*

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Abstract

The agricultural sector in transitional and emerging market economies is marked by the prominence of agroholdings, i.e., conglomerates of agricultural enterprises controlling up to hundreds of thousands of hectares of farmland. Drawing on secondary information from Ukraine, this paper explores how institutional turbulence gives rise to agroholdings. The key hypothesis is that membership in an agroholding presents a strategy for agricultural enterprises to remain resilient in the midst of the severe institutional turbulence characteristic of a transitional economy. The focus on resilience provides a tentative explanation of why the remarkable growth of agroholdings fails to be accompanied by evidence of their superior efficiency.

Keywords: agroholdings, environmental turbulence, firm growth, resilience, transition economy
JEL: L220, P320, Q120

Introduction

The development of so-called agroholdings is a well-documented phenomenon for a number of transitional and emerging market economies (Chaddad/Valentinov 2017; Visser et al. 2012). Agroholdings are large-scale farming entities typically consisting of a mother company that holds a controlling stake in dozens or hundreds of corporate farms and manages several dozens or hundreds of thousands of hectares of farmland (Hermans et al. 2017). Along with specialisation in crop production, agroholdings include elements of vertical integration with multiple stages of the agri-food supply chain, such as animal production, distribution of inputs, logistics, exports, and food manufacturing (Matyukha et al. 2015). For the most part, the development of these large enterprises is possible due to the inflow of excess capital from other industries that allows for the growth in land and assets through the acquisition of other, non-holding enterprises (Petrick et al. 2013).

* Received: 02.03.2018, accepted: 25.10.2018, 2 revisions.

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A surprising fact, however, is that agroholdings continue expanding despite being generally inefficient. Agroholdings are reported to suffer from disadvantageous cost structures caused by their propensity to employ more labour and spend more on production inputs than non-holdings (Lapa et al. 2015; Petrick 2017). Agroholdings' ability to outperform other farms due to lower susceptibility to transaction cost problems is questionable as well (Lapa et al. 2015). The bottom line is that, on average, farms in agroholdings do not seem to be more profitable or efficient than those not in agroholdings, and therefore, the growing membership base of agroholdings challenges traditional views on the nature of firm growth. Conventional wisdom indicates that firm growth strategy is driven by efficiency considerations, i.e., firms are assumed to decide whether to grow organically, by the use of their own available capacities, or through mergers and acquisitions based on the efficiency gains or losses each of the modes of growth entails (Williamson 1985; Thompson and Valentinov 2017). However, the case of agroholdings' growth demonstrates that relatively efficient enterprises deliberately forego the possibility to grow on their own, instead choosing to join less efficient, slow-growing structures. This firm behaviour casts doubt on the validity of the efficiency rationale for growth.

Most studies that compare the efficiency of agroholdings and non-holding farms in transitional economies fail to be comprehensive because the ongoing activity of agroholdings occurs amidst underdeveloped markets for capital and land (Gagalyuk 2017). Coupled with inadequate first- and second-order institutions (Koester 2005; Sutela 2012), these market imperfections shape the highly volatile business environment that renders market functioning unpredictable and may undermine the ability of traditional types of farming to survive. The central contention of the present paper is that, given the high volatility of the business environment, it is most likely resilience, rather than economic efficiency, that primarily determines the farms' choice to grow through membership in an agroholding.

The concept of resilience (Pal et al. 2014; Gunasekaran et al. 2015) has recently gained currency among those organisational theorists who have become keenly aware of the radical influence of the external environment on organisational systems. According to this concept, a resilient organisation possesses the capability to maintain critical variables and the stability of an internal environment despite turbulent external environmental conditions (Burnard/Bhamra 2011: 5583). In the strategic management literature, environmental turbulence is understood as a measure of change in the components of a firm's environment (Smart/Vertinsky 1984: 200) or volatility and difficult-to-predict discontinuities in an environment (Haleblian/Finkelstein 1993: 845). The burgeoning literature on organisational resilience addresses the sources of environmental turbulence, such as a disruptive market and technological changes (Fainschmidt et al. 2016), as well as natural and man-made disasters (Rose/Krausmann 2013). However, organisational

resilience scholarship has rarely addressed the institutional turbulence that originates from the institutional foundation of the markets itself (Gagalyuk et al. 2018), and it is this turbulence that renders the efficiency rationale for firm behaviour so precarious.

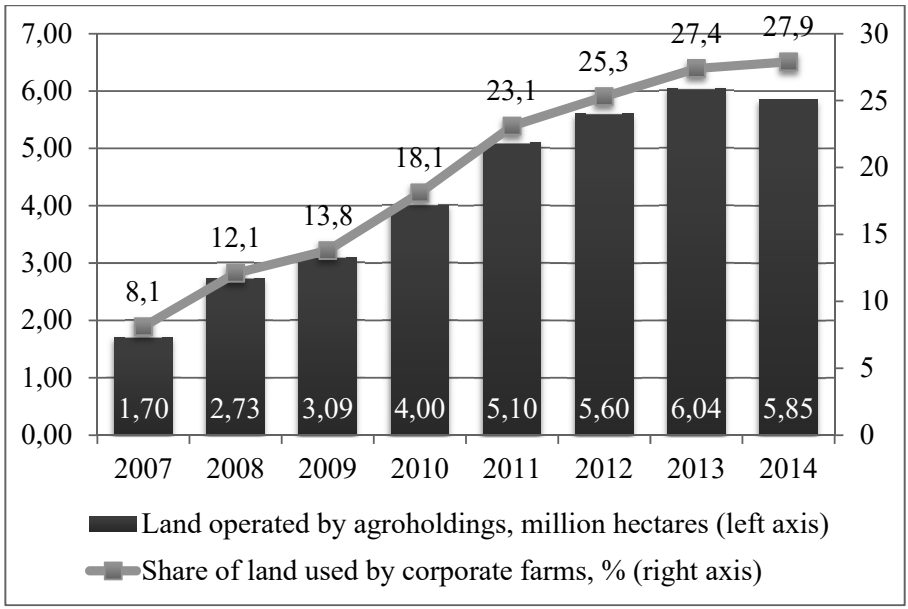
With particular reference to the transitional context characterised by underdeveloped markets and poor institutions, this paper addresses the research question of how institutional turbulence gives rise to agroholdings. In doing so, the paper extends the existing organisational resilience theory by showing that environmental turbulence arises not only from market disruptions, technological discontinuities and natural or man-made catastrophic events but also from institutional shortcomings. In line with the literature on organisational resilience, this argument demonstrates that firm growth in turbulent environments is no less about resilience than it is about efficiency.

Drawing on the recent history of Ukrainian agroholdings, the paper demonstrates that firm growth in a turbulent environment, which is marked by pervasive institutional problems, drives firms' preferences for resilience over efficiency. The following section highlights some key facts about agroholdings in Ukraine. The subsequent section discusses the rise of agroholdings as a reaction to institutional turbulence. Conclusions and implications for further research follow.

The development of agroholdings in Ukraine

The result of structural change in Ukrainian agriculture so far is that some 80 agroholdings, whose sizes exceed 10,000 hectares each, operate approximately six million hectares or approximately 30% of total farmland in the use of corporate farms (Figure 1). To exemplify, the two largest agroholdings, Ukrlandfarming and Kernel, manage slightly more than 600,000 hectares each (Latifundist.com 2017). Additionally, Ukrlandfarming is the largest industrial egg producer in Eurasia (Ukrlandfarming 2017), while Kernel is the number one sunflower oil exporter in the world (Kernel 2016). The example of these two agroholdings suggests that, apart from expansion in the sector of primary agriculture, agroholdings often integrate enterprises from different upstream and downstream stages of the agri-food supply.

Figure 1. Farmland area operated by agroholdings in Ukraine



Source: UCAB (2015).

In part, agroholdings were able to proliferate due to the inflow of excess capital from non-agricultural sectors (Petrick et al. 2013; Gagalyuk 2017). Additionally, this expansion was driven by some important market and political developments throughout the 2000 s. First, large-scale technology- and knowledge-based farming was instigated by the growing global demand for food, fibre, and energy (Hermans et al. 2017). Second, the orientation of public policies towards self-sufficiency in the food supply, the growth of agricultural exports, and the deregulation of domestic markets favoured large-scale industrialised agriculture over traditional family farming (Matyukha et al. 2015).

Earlier studies particularly emphasised the role of the public sector in the development of agroholdings. Vast tax exemptions and heavy subsidisation gave a boost to the continuous scale-up of large forms of production organisation (Visser et al. 2012). Added to this was and still is the moratorium on farmland sales in Ukraine that enabled the consolidation of very large land areas through the mechanism of leases (Lapa et al. 2015). While the state was busy arranging these favourable conditions for large corporate farming, processes of institution building in the social sphere as well as in other branches of public policies continued (Keyzer et al. 2013). Eventually, this led not only to a growing uncertainty regarding the strategic factor markets, i.e., capital and land markets, but also to a worsening socio-economic situation in rural areas, which increased societal

pressure on agriculture and brought the problem of the labour deficit to the forefront.

Given these circumstances, it seems safe to conclude that the development of the agroholding type of farming in Ukraine was, and still is, to a great extent, the result of high environmental turbulence. Marked by institutional problems and underdeveloped strategic factor markets, uncertain business conditions pose a major challenge to the sustainability of traditional types of farming. To demonstrate that membership in agroholdings presents a resilient strategy for farms in their attempts to respond to this type of turbulence, we further address the status quo of the institutional environment in Ukrainian agriculture by drawing on secondary information and previous research findings. Particular attention is drawn to institutional problems in the markets for finance, land, and labour that contribute to the shift in institutional equilibrium.

Institutional turbulence in strategic factor markets: the case of agriculture in Ukraine

Financial markets

The underdeveloped financial markets have long been assumed to be an obstacle to corporate growth (Peng/Heath 1996). If that would be a fully non-relaxable assumption, however, the story of growth of Ukrainian agroholdings would end here. Indeed, an effective stock market has not yet been developed in Ukraine, while commercial banks are providing loans under very restrictive refinance rates (UCAB 2013). Nevertheless, business size and the diversified structure of agroholdings have been conducive to attracting outside capital from a number of alternative sources.

From the mid-2000 s to the mid-2010 s, some twenty Ukrainian agroholdings were able to raise approximately $1.5 billion in total through the initial public offering (IPO) of their shares on international stock exchanges (UCAB 2014). Among the ten largest agroholdings in terms of farmland, seven are or were listed on international stock markets such as the Frankfurt Stock Exchange, London Stock Exchange, and Warsaw Stock Exchange (see Table 1). In addition to international listings, several agroholdings received loans from international finance institutions such as the European Bank for Reconstruction and Development (EBRD) and the World Bank Group's International Finance Corporation (IFC). The concerned loans are or were targeted at financing working capital, land lease rights, the expansion of processing lines and storage capacities and are often complemented by technical assistance and advisory services from the donors (EBRD 2016; IFC 2014).

Table 1. International capital raising by the top 10 largest Ukrainian agroholdings

Company name	Land use, thousand hectares (2017)	Major owner	Sources of outside capital		Shares placed during IPO, %	Capital raised through IPO, USD million	Capital raised from other international sources, USD million
			IPO on stock market (Date of IPO)	Other sources (Eurobonds, project finance, etc.)			
Ukrlandfarming	605.0	Oleg Bakhmatyuk	LSE[a] (May 2010)	ISE[b]	22.5	186.0	500.0
Kernel	602.5	Andriy Verevskyy	WSE (Nov 2007)	ISE[b]	36.0	218.0	665.0
Agroprosperis	430.0	NCH Capital (George Rohr, Moris Tabacinic)	n.a.	NCH Capital, EBRD	n.a.	n.a.	30.0
MHP	370.0	Yuriy Kosyuk	LSE (May 2008)	IFC, EBRD, ISE[b]	22.3	322.5	885.0
Astarta	250.0	Viktor Ivanchyk	WSE (Aug 2006)	EIB, IFC, Fairfax Holdings, FMO	14.6	31.0	87.0
Mriya	185.0	The Huta family	FSE[c] (Jul 2008)	EBRD, IFC, USEXIM, EKF	20.0	90.0	200.0
Agroton	151.0	Yuriy Zhuravlov	WSE (Nov 2010)	LSE[b]	26.2	54.0	50.0
IMC	136.6	Oleksandr Petrov	WSE (May 2011)	IFC, EBRD	24.0	30.0	50.0
Agrain	127.0	Pavlo Ovcharenko	n.a.	n/a	n.a.	n.a.	n/a
Ukrprominvest	122.0	The Poroshenko family	n.a.	n/a	n.a.	n.a.	n/a

Sources: multiple years' data of stock exchanges; corporate reports and websites of agroholdings; reports of IFC and EBRD; Cbonds[1] reports.
[a] Ukrlandfarming is listed on London Stock Exchange with its daughter holding Avangardco.
[b] Capital raised through issue of Eurobonds and listing on a respective stock exchange.
[c] Mriya was delisted from FSE in 2014.
EBRD = European Bank for Reconstruction and Development; EIB = European Investment Bank; EKF = Danish Export Credit Agency; FMO = Dutch development bank; IFC = International Finance Corporation; FSE = Frankfurt Stock Exchange; ISE = Irish Stock Exchange; LSE = London Stock Exchange; USEXIM = Export-Import Bank of the United States; WSE = Warsaw Stock Exchange; n.a. = not applicable; n/a = not available.

Apart from growth financing and technical assistance, access to international capital sources entails changes in business models, as it requires new approaches to corporate governance and transparency in both reporting and operation (Horváth et al. 2017). While relying on closely held ownership structures, non-

1 http://cbonds.com/.

holding farms are generally unable to achieve such strategic change, as they cannot utilise outside directorship on the board or diversify their top management teams. Constraining as they are for non-holding agricultural enterprises, these requirements are increasingly regarded as contributing to the resilience of agroholdings. The presence of independent directors on the boards, independent auditing and disclosure of information about owners and financials serve as safeguards against opaque business practices. This type of transparency is particularly important in the face of frequent transition-specific problems, such as raider attacks and hostile takeovers (Rojansky 2014).

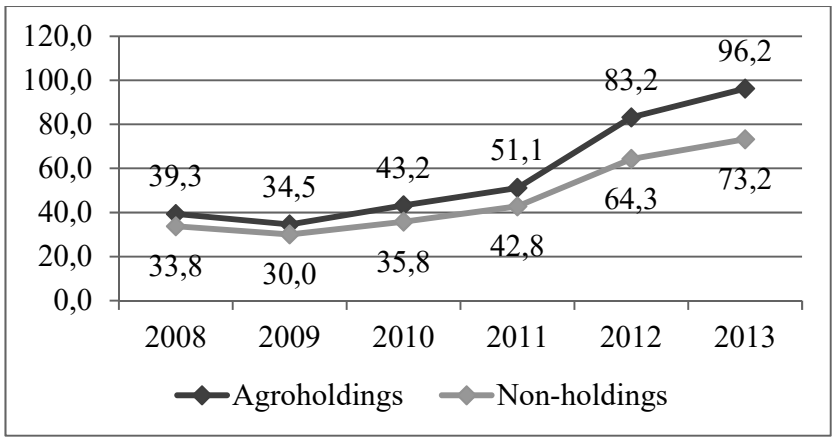
Another remarkable outcome of these new requirements towards transparency is their spillover effect such that not only investors and shareholders but also other stakeholder groups become addressed. Handbooks on corporate culture for employees, sustainability requirements for suppliers, and corporate newspapers for rural communities are becoming common practice among agroholdings (Astarta 2017; MHP 2016). These initiatives usually require additional investments and thus stand in contrast to an efficiency orientation. As a result, they can be implemented more effectively and at a wider scale through diversified and financially strong structures such as agroholdings rather than through the production-focused structures of non-holding farms.

Land market

Ukraine's Land Code allows certain farmland transactions for owners – rural households and family farms. However, the moratorium on buying and selling land is still in effect. In addition, the investment of agricultural land in the equity capital of businesses is banned. According to the government, this is a precautionary measure that aims to counter pressure from farm managers on landowners to transfer their land to corporate farms. At the same time, the Land Code does not limit the lease term, and very long-term leases lead to a de facto absorption of land in corporate equity (OECD 2003). The expansion of large-scale farms is one of the outcomes of this legal framework. Another outcome is that the land lease is an important source of income for rural residents. As landowners, they earn money from renting out their plots of land to corporate farms (Lerman et al. 2007).

The available evidence suggests that non-holding farms cannot afford to pay higher rents to landowners than farms in agroholdings, as they are financially constrained relative to agroholdings (see Figure 2). Consequently, non-holding farms are disadvantaged in the context of increasing competition for land under uncertain lease terms. Since a lease is the only way to access land, non-holding farms' lease agreements are insecure due to the threat that a significant number of lessors may obtain better lease price offers from agroholdings.

Figure 2. Annual average farmland rents paid by agroholding and non-holding farms, USD / ha



Source: own calculations based on the UCAB database.

It should be noted that the turbulence in the farmland market is intertwined with uncertainties of a technological and social nature. Increasing farmland rent prices compel farms to constantly search for and introduce new technologies. The adverse effects of this process are manifested in growing unemployment and other social problems in rural areas. This puts farms under growing societal pressure and gives weight to their corporate social responsibility (CSR) activities. Notably, most Ukrainian farms inherited the service delivery feature of former Soviet kolkhozes to a certain degree (Gagalyuk/Schaft 2016), but as they are considerably smaller in size, non-holding farms have a substantially less developed capability to address landowner communities' needs. While agroholdings establish special charity funds and departments in charge of community development issues with annual budgets of up to $2 million (MHP 2016; Kernel 2016), non-holding farms' support to landowners is most often limited to ad hoc activities, such as the ploughing of a vegetable garden located next to a landowner's household or the removal of snow from rural access roads in winter. In contrast, the CSR of agroholdings includes both ad hoc aid and well-planned infrastructural projects. Agroholdings offer charitable donations to schools, hospitals, churches, sports clubs and kindergartens; provide their own finance, machinery and equipment for infrastructure works, construction and repair of electricity lines, and water and gas pipelines; and are involved in other related activities (Astarta 2017; Kernel 2016; MHP 2016).

Labour market

As a transitional country, Ukraine generally suffers from the inadequacy of safety nets provided by the public sector. Contrary to expectations, the reforms implemented in the social sphere have continuously failed to improve welfare, particularly in rural areas. The most dramatic has been the loss of employment accompanied by labour migration to cities and abroad. The supply of social services has also declined due to the lack of purchasing power (Keyzer et al. 2013).

Against this background, non-holding farms again appear to be less suited to solving these types of problems. Their narrow specialisation in crop production does not allow for an extensive offer of alternative jobs, for example, in milk production (see Table 2).

Table 2. Employment and pay in Ukrainian corporate farms

		2008	2009	2010	2011	2012	2013
Employees per 1000 hectares of total farmland	Agroholdings	35.1	30.7	29.6	28.8	28.2	27.1
	Non-holdings	31.8	28.9	27.5	26.9	25.4	24.1
Employees in crop production per 1000 hectares of arable land	Agroholdings	22.5	19.4	18.9	18.7	18.8	17.5
	Non-holdings	23.1	21.1	20.2	20.3	19.1	18.6
Employees per 100 cows in milk production	Agroholdings	48.4	44.5	44.3	44.0	39.1	39.5
	Non-holdings	30.3	29.8	28.5	26.9	24.6	23.6
Average salary, USD* per worker	Agroholdings	184.6	138.9	157.1	192.8	213.1	245.1
	Non-holdings	151.3	112.6	130.5	182.8	184.7	206.3

Source: own calculations based on the Ukrainian Agribusiness Club (UCAB) database**.
*As per the official annual average exchange rate of the National Bank of Ukraine.
** The UCAB database contains information about the whole population of approximately 8,500 Ukrainian corporate farms on the data points such as land use, employee numbers, production volumes, costs, and sales of agricultural production as well as farm affiliation with an agroholding. All the data, except the agroholding affiliation, come from official statistics provided by the State Statistics Service of Ukraine. UCAB adds an update on farms' affiliations with agroholdings based on an annual survey of corporate farms and continuous monitoring of the reports of the Antimonopoly Committee of Ukraine on farm acquisitions.

While the substitution of technology for hired labour is, to a greater or lesser extent, common to all farm types in Ukraine, unattractive living conditions in rural areas worsen this situation by forcing young people to leave in search for better opportunities. The result is a growing deficit of qualified farm workers that the majority of corporate farms face (Koester et al. 2010). In agroholdings, this issue gives weight to professional human resource management (HRM), as it impels agroholding management to increasingly design and offer above-average compensation packages and qualification improvement programmes (Morley et al. 2016) for both managers and non-managerial workers. Staff retirement pay,

profit sharing and health protection schemes are becoming an indispensable part of employee compensation. In non-holdings, the development of HRM is still at the level of Soviet-type kolkhozes, i.e., unattractive for talented workers (Petrick 2017).

The above-average benefits are additionally able to promote employees' self-identification with and loyalty to an employing company. This seems to be particularly important in the midst of pervasive employee fraud in Ukrainian agriculture (Gagalyuk/Schaft 2016). For the most part, this problem exists due to the embedded institutions, which accompany the transformation process in former planned economies. Rural societies in Ukraine and some other transitional countries are characterised by high risk aversion, lack of trust, preference against being self-employed, lack of self-reliance, and corruption and nepotism (Koester 2005). Professional HRM and new labour monitoring technologies provide successful solutions to the problems of opportunistic behaviour by employees (Chaddad/Valentinov 2017). However, investments in these solutions often fail to pay off quickly. Due to the lack of requisite infrastructure and funds in non-holding farms, such investments are much more extensively realised in agroholdings.

Conclusion

The extant literature on agroholdings in Ukraine as well as other transitional countries exhibits several highlights whose inter-related logic has not been fully clear. Agroholdings are very large and thus exemplify the radical expansion of the firm boundaries; their rise to prominence cannot be traced back to their superior efficiency compared to other forms of agricultural enterprises; they operate in the transitional business environment marked by a high degree of institutional turbulence. The present paper ties three highlights into a coherent story drawing on the core idea of resilience. The high degree of institutional turbulence exposes the traditional forms of agricultural enterprises to severe existential risks, disrupting their access to critical finance, land, and labour resources. Agricultural enterprises seek to cope with these risks by joining agroholdings that facilitate access to these resources and create a type of protected enclave in which enterprises can concentrate efforts on the organisation of production.

Crucially, this rationale for membership in an agroholding is centred on resilience rather than efficiency. The focus on resilience rather than efficiency thus provides a tentative explanation for why the remarkable growth of agroholdings fails to be accompanied by evidence of their superior efficiency. This explanation lends credence to the extant organisational resilience scholarship by reaffirming that the exclusive focus on the idea of efficiency is not only scientifically incomplete but also potentially dangerous from the sustainability point of view. For all the merits of the efficiency idea, it alone cannot explain the sur-

vival and decline of firms that are embedded in the complex textures of socio-ecological systems, except in the negative sense of the sustainability risks associated with the exclusive focus on efficiency. The organisational resilience scholarship emphasises the point that a firm's survival may call for the firm's resilience no less than its efficiency.

In terms of implications for further research, the organisational resilience literature may benefit by acknowledging that agroholdings exemplify a growth strategy and a resilience strategy at the same time. This is possible because the main risks to the sustainability of agricultural enterprises come in the form of institutional turbulence. Far from being generally incompatible with growth, resilience strategies turn out to be contingent on the nature of the relevant sustainability risks. More generally, further research is needed to explore the limits of the efficiency-based explanations of organisational survival. If these explanations indeed ignore the limits of the carrying capacity of the relevant social and natural environment, then the idea of resilience must be taken seriously, and conventional business growth strategies may not be attractive.

Acknowledgments

The first author gratefully acknowledges the support from the Leibniz Association.

The second author gratefully acknowledges the support from the German Research Foundation (DFG).

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