Success Factors for New Generation Cooperatives

Jared G. Carlberg
Assistant Professor, University of Manitoba

Clement E. Ward
Professor and Extension Economist, Oklahoma State University

Rodney B. Holcomb
Associate Professor and Charles B. Browning Professorship, Oklahoma State University

Some agricultural producers have formed New Generation Cooperatives (NGCs) in an effort to add value to their farm commodities. Typically, an NGC retains the traditional cooperative tenets of one member, one vote and dividends based on patronage, but has two important additional characteristics (Stephanson, Fulton, and Harris).

First is delivery rights tied to share issuance. Investors in NGCs typically help fund construction or purchase of a processing facility through the purchase of shares. Purchases of shares carry the right and obligation to deliver one unit of the applicable commodity per share. Total delivery rights typically equal the annual processing capacity of the facility. The second unique NGC characteristic is restricted membership. Membership is limited to those who provide the equity capital (and thus incur the risk) for the venture, and new shares are generally not issued unless the processing facility requires expansion.

Research was undertaken at OSU to determine the factors that managers of NGCs thought were important to success of NGCs. This extension facts identifies the success factors managers indicated were important.

Determining the Key Success Factors

Opinions of NGC managers were obtained via a mailed survey. Managers of 72 NGCs were contacted in advance and later mailed a questionnaire. The response rate after three mailings was 75%. Respondents were asked to rank five factors in each of ten category groups as first through fifth most important to the success of their value-added enterprise. The within-category ranking was then weighted by how important respondents rated the category to arrive at a final ranking for each of the fifty factors for each NGC. For instance, the factor ranked highest in the category ranked highest would likely be most important to the success of NGCs according to NGC managers. Conversely, the factor ranked fifth (lowest) in the category ranked tenth (lowest) would likely be the factor least important for success in the opinion of NGC managers. This weighting procedure allowed an overall ordering of the factors in terms of importance.

Most Important Factors

Table 1 (page 5) shows the overall rankings of success factors across all NGCs after the weighting system described above was applied. The importance of factors in the "planning and development" category is evident. Three of the five most important factors come from that category. This is due in part to the fact that so many of the respondents are fairly new businesses, with the overwhelming majority having been in operation for less than ten years. Accordingly, difficulties encountered in the early stages of operation and, more importantly, the successes achieved by struggling through these difficulties are likely still fresh in respondents' minds. Overall, the existence of strong local leadership in the beginning stages is recognized as the most important success factor across all respondents and the related "steering committee" was identified as third most important. Cooperative development personnel can relate stories of how, now-successful, NGCs were sustained through their earliest days by the tireless labors of organizers who refused to let a good idea die. In many cases, these local champions spent considerable amounts of their own time and money organizing meetings to garner support for a start-up cooperative. Also from the "planning and development" category, "feasibility study" was chosen as the fifth most important overall factor out of the fifty considered.

Two factors from the "financing and costs" category were also among the five most important success factors for value-added cooperatives. In second place was "low operating costs," and in fourth place was "member capital base." The former was important across all types of NGCs. In some cases, large NGCs exist in industries that are quite competitive both in terms of output and input prices and businesses can only affect their margins by controlling operating costs. For other, smaller cooperatives, certain types of fixed costs must be spread across relatively few units of output, and there are few opportunities to take advantage of economies of size. For this reason, operating costs for the cooperative must be carefully monitored, and paying for management or sales expertise, a marketing campaign, or even part-time staff may not be feasible.

A sufficient pool of member capital is also critically important to most NGCs. Oftentimes, a processing facility must be purchased or constructed, and the cost of doing so can run into the tens of millions of dollars for even a modest facility. Lenders are usually unwilling to back such a project without at least forty or fifty percent of capital provided by members in the form of equity. Sometimes, even once a plant is purchased or built, further injections of capital are required of members. A number of potentially successful value-added cooperatives have failed either because of a lack of start-up money or operating capital.

Three of the next five most important factors were in the "managerial" category. Not surprisingly, managers consider management important to the success of NGCs. Others in the second set of five came from the "product related" (product quality) and "operational" (strong selling/marketing effort) categories. These would logically be high on many lists of success factors for value-added products.

Key Factors for Specific Commodity Groups

Respondent NGCs were categorized into similar commodity groups and then success factors identified for each group in the same manner as for the overall rankings discussed above. Table 2 (page 6) shows the five most important factors identified for each of the commodity groups. Not surprisingly, 15 of the 30 factors were among the five most important factors across all NGCs. Each of the commodity groups is discussed briefly below. More detail can be found in Carlberg, Ward, and Holcomb, which is available from the authors.

Ethanol NGCs – The largest group, with 14 respondents, consists of cooperatives engaged in the production of ethanol from corn. For a Missouri grain NGC, project leaders played an important role in educating producers about what was at that time the first NGC in Missouri. They were also instrumental in encouraging that state to update its legal institutions to be able to accommodate the new type of venture. Similar experiences in other areas help explain why strong local leadership during the developmental phases was rated as the most important success factor for ethanol NGCs.

"Strong selling/marketing effort" was ranked second most important by ethanol NGCs. The importance of this factor to cooperatives in this group is somewhat unique in that it was not ranked in the five most important factors by NGCs in any other commodity group. However, marketing was one of the toughest challenges facing a specific NGC in southwest Minnesota. A strong selling/marketing effort is important to ethanol NGCs because the market for their output has become increasingly competitive.

Ethanol plant managers play a critical role in maintaining product throughput and good conversion rates of corn to ethanol and a myriad of other day-to-day tasks. Thus, "full-time general manager" was rated as third most important for the success of ethanol NGCs.

Construction of a new processing facility is necessary for almost every group hoping to form an ethanol co-operative, and the costs associated with doing so can be considerable. Given a construction cost of between $1.40 and $2.00 per gallon of yearly capacity, even a small facility producing 15 million gallons per year would cost at least $21 million and perhaps as much as $30 million to build. It is easy to see why "member capital" was ranked as the fourth most important success factor for ethanol NGCs.

Related to the significance of a strong local champion or leader is the importance of carrying out a feasibility study for any new large-scale enterprise, ranked as the fifth most important success factor by managers of ethanol NGCs. It is critical that a prospective ownership group gauge producer interest in the NGC, determine the availability of inputs, assess the suitability of available sites, evaluate prospective partners for design/construction of the processing facility, and carry out various other tasks to ensure that the project is feasible before embarking on the road to full-scale production. Failure to plan properly is a surefire way to fail when organizing a value-added enterprise.

Livestock NGCs – There were six NGC respondents engaged in various value-added activities grouped under "livestock." Many such enterprises were inspired by the success of U.S. Premium Beef (USPB), an NGC that initially acquired a significant ownership stake in Farmland National Beef, thus gaining access to its lucrative branded beef sales. USPB has been successful at not only enhancing returns for producer-members, but also at helping those producers raise better animals by providing significant carcass data feedback and pricing on a carcass-merit grid. The presence of a strong local champion/leader was identified as the most important factor for livestock NGCs and early organizing efforts were integral to the success of USPB.

The beef industry has suffered from its inability to produce a consistent, convenient product that is as affordable as chicken or pork. Thus, the closely linked factors "product quality" and "reputation" were ranked as second and fifth most important, respectively, for livestock NGCs. The high ranking of these factors is not surprising given the emergence of branded meat products as a major profit center for livestock NGCs.

"Multiple market sales" was chosen as the third most important success factor for livestock NGCs. This was not surprising given the multitude of products and markets for meat products.

"Member capital" was selected as the fourth most important factor for the success of livestock NGCs. Oftentimes, livestock producers desire to undertake processing to capture what they perceive to be excess profits by competing processors. But packing plants are very expensive to build, and even the cost of purchasing a recently abandoned facility can be prohibitive. Even start-up costs can strain the resources for start-up NGCs. Given high start-up and construction costs for processing facilities, it is easy to see why livestock NGCs depend critically upon a sufficient member capital base for success.

Food Processing NGCs – Seven NGCs that process commodities into table-ready or oven-ready products were placed together into a "processed/semiprocessed foodstuffs" group. Cooperatives engaged in the processing of sugar beets, table nuts, coffee, poultry, and eggs were included in this category. The NGCs in this group are distinct from those in other groups in a number of important ways: they are often older businesses, typically are engaged in very capital-intensive processing activities, often control a large share of the domestic market for their products, and many are readily identifiable with easily recognizable brand names.

"Low operating costs" was chosen as the factor most important to the success of cooperatives in this group. This is due in part to the complex nature of the operation of this type of NGC. A number of NGCs in this group operate in industries with very tight margins. As such, firms must focus on controlling operating costs, as they may not be able to exert much influence over output prices.

Given the competitive, often low-margin nature of the markets in which some food processing NGCs operate, effective management can often be the difference between success and failure. "Managers with industry knowledge" was identified as the second most important success factor for food processing NGCs. Coming in third was "steering committee," again demonstrating the importance of planning in the early stages of NGC formation.

Two more closely related factors from the "financing and costs" category were ranked among the top five for food processing NGCs. In fourth place was "low financing costs," followed by "member capital base." Again, adequate member capital, in part to reduce the burden of extensive borrowing is especially important for start-up NGCs.

Wheat/Oilseed NGCs – Farmer-owned cooperatives that process wheat or oilseeds (mainly soybeans) were considered as a single group. Seven such NGCs responded to the survey. A few of the wheat processing businesses in this group were vertically integrated from farm production to sales of bakery or partially-baked products; others were engaged in the production of pasta from durum semolina. On the oilseed side, most respondents consisted of producer groups who had banded together to purchase or construct a facility for processing their soybeans because no suitable facility was located close to them, or because they were dissatisfied with pricing arrangements being offered by existing processors.

Commonalities were that both types of NGCs in this group were almost without exception less than five years old, and that they had taken an ownership position in a processing facility at considerable risk and expense to producers. These factors may make this group seem similar to ethanol NGCs, but wheat and oilseed processing cooperatives typically are not favored by having their demand enhanced by government regulatory policies, nor do they receive the same levels of financial assistance as do ethanol producing cooperatives. Managers of NGCs in this wheat or oilseeds group identified "labor force quality" as the factor most critical to the success of their enterprises. Though the processes in these businesses are not particularly labor intensive, nevertheless, careful supervision and maintenance of the plant and equipment is crucial. Also, since many of these NGCs are located in small rural centers, the supply of semi-skilled labor can be viewed as a precious commodity. For NGCs vertically integrated into consumer-ready products, skilled labor can be even more difficult to find.

The cost of construction of a new facility or purchase of an existing one is considerable for a wheat or soybean processing NGC. In some cases, the financial commitment required of producer-members seems considerable given what some view as very limited delivery rights attached to membership. Farmers generally expect farm-gate returns for their commodities to improve due to NGC membership, but often membership only provides a hedge for a small proportion of farm production. Therefore, "market size" for wheat and oilseed NGCs is a concern and was the second most important factor mentioned for this group.

As with other commodity groups, wheat and oilseed processing NGCs described factors in the "planning and development" category as being critically important to their success, rating "steering committee" and "feasibility study" as the third and fourth most important factors, respectively. Like having a local champion or leader, a strong, dedicated steering committee is an important element of early planning for a new processing venture. Similarly, a thorough feasibility study is a must to determine producer interest in the new venture, availability of inputs, and potential markets for the finished product.

Providing consistent quality to customer specifications is one of the principle competitive advantages in the pasta producing industry. Similarly, in the soybean crushing industry, firms compete on product quality, among other factors. It is for these reasons that wheat and oilseed processing NGCs rated "product quality" as the fifth most important factor to the success of their businesses.

Organic/Vegetable/Seafood NGCs – The second-largest NGC group consisted of ten enterprises engaged in the marketing of organic or conventional table vegetables and seafood. This, too, is a unique category of cooperatives. NGCs often require considerable financial outlays by producer-members to fund the purchase or construction of large-scale processing facilities. For organic/vegetable/seafood NGCs, this is not necessarily the case. Rather, for a number of the cooperatives in this group, adding value to commodities produced consists of little more than assembling boxes of the commodity at some common collection point to be collectively marketed to customers by a single seller. Sometimes, there are as few as a dozen members in these cooperatives; other times, there are several hundred, marketing under well-known brand names. In any case, these cooperatives qualify as NGCs because they are closed cooperatives where members have banded together to add value to their commodities. As will be explained below, the factors that are most important to the success of this type of enterprise are often quite different than those for other kinds of NGCs.

Close contact with customers has helped some of these NGCs ensure repeat and growing sales. Perhaps that is why "customer service" was rated as the most important success factor for this type of enterprise.

Two factors from the "product related" category were ranked among the five most important by managers of vegetable/organic NGCs. Rated second was "product quality," not a surprise given that consumers of these products expect consistent good taste and freshness. Ranked fourth most important was "unique product." Purchasers of organic food are not only interested in the natural production of the products they buy because of health concerns; they also place importance upon the social and environmental benefits that organic production often represents. As such, organic products, and in some cases non-organic locally grown products, are seen as unique.

Strong local leadership in the planning stage was identified as the third most important success factor for vegetable/organic NGCs. This factor was selected among the five most important for four of the six commodity groups.

"Low operating costs" was the fifth most important success factor by NGCs in this category. Even though there are significant premiums to be earned for organic or locally grown products, there are substantial per-member costs for operating cooperatives with relatively few members. As such, minimization of costs is an important consideration for these businesses.

Other NGCs – Six of the respondents did not fit into any of the categories described above and were placed together in the "other" group. Their activities range from forestry to alfalfa production to wine production, as well as two so-called "producer alliances," and one anonymous response. Each of the five factors this group identified as most important was identified in the top five by at least one of the other NGC groups. This further demonstrates that even though there are important differences among the rankings of various factors by certain groups, there are commonalities between them that represent the importance of particular factors to all types of NGCs.

Summary and Implications

New Generation Cooperatives (NGCs) are becoming increasingly more common as agricultural producers strive to increase their share of the value produced by their commodities. This extension facts summarized the success factors deemed important by managers of NGCs. This information in intended to aid the development of new NGCs as well as in the management of existing ones. Based on the research reported here, the following points can be made:

- *Planning is paramount*. Most NGC managers identified factors in the planning and development category as very important to success. Three ranked highest included having a local champion or leader, a steering committee, and conducting a feasibility study.
- *Financing and controlling costs are critical*. Carefully managing operating costs is important to earning profits. NGCs that are able to take advantage of economies of size improve their chances of being profitable. Also, having an adequate member capital base was identified as key to success of NGCs.
- *One size does not fit all*. Though some commonalities exist among successful NGCs, factors important to NGC success can vary significantly depending upon commodity group.

Clearly, examples can be found of NGCs that have failed due to poor planning, ineffective management, or adverse market conditions. Recognizing factors important to success of a particular type of NGC should help increase the success rate for NGCs, and for all value-added agribusinesses, thus enhancing opportunities for producers to capture more of the value added to their commodities. Producer-owned, value-added NGCs can make important contributions to agricultural producers and to rural areas, keeping people and resources from relocating elsewhere.

References

Carlberg, Jared G., Clement E. Ward, and Rodney B. Holcomb. "Success Factors for Value-Added New Generation Cooperatives." Winnipeg, Manitoba, Canada: Department of Agricultural Economics, University of Manitoba, July 2004.

Stephanson, B., M. Fulton, and A. Harris. *New Generation Cooperatives: Rebuilding Rural Economies*. Center for the Study of Co-operatives, University of Saskatchewan, Saskatoon, SK, 1995.

Table 1. NGC Overall Success Factors and Categories

Category Factors	Overall Rank	Category Factors	Overall Rank
Planning and Development		**Financing and Costs**	
Local champion(s) or leader(s)	1	Input price stability	20
Steering committee	3	Output price stability	17
Feasibility study	5	Low operating costs	2
Alliance/partnership	8	Low financing costs	11
Proximity to other successful co-ops	26	Member capital base	4
Managerial		**Product Related**	
Full-time general manager	10	Product uniqueness	41
Experienced managers	8	Product quality	7
Continuity of management	13	Technology incorporated	35
Managers with industry knowledge	6	Customer service	22
Ongoing managerial training	31	Brand recognition	44
Operational		**Human Resource/Organizational**	
Business volume	16	Quality of labor force	18
Risk management	14	Use of outside experts	47
Vertical integration	36	Communication within co-op	27
Strong selling/marketing effort	9	Communication with board	34
Targeted customer base	23	Communication with members	45
Government/Regulatory Environment		**Strategic**	
Co-op existence laws	24	Product focus	11
Co-op tax advantages (e.g. 521 tax status)	30	Enforced member agreements	46
		Ongoing planning/checking	32
Demand enhanced by regulation	48	Business strategy	15
Direct government agency funding	38	Multiple-market sales	29
Government planning support/technical assistance	49		
Logistics		**Industry**	
Site selection	40	Reputation	21
Proximity to inputs	25	Economic climate	43
Proximity to customers	42	Market size	28
Transportation/distribution infrastructure	33	Number of competitors	37
		Competitors' prices	39
Geographical member dispersion	50		

Table 2. Top Five Success Factors by Commodity Group

Rank	Ethanol	Livestock	Food Processing	Wheat/Oilseed	Organic	Other
1 or leader(s)	Local champion(s) or leader(s)	Local champion(s) costs	Low operating force	Quality of labor	Customer service with industry	Management
2 marketing effort	Strong selling/	Product quality with industry	Management	Market size	Product quality base	Member capital
3 general manager	Full time	Multiple-market sales	Steering committee	Steering committee or leader(s)	Local champion(s) or leader(s)	Local champion(s)
4	Member capital base	Member capital base	Low finance costs	Feasibility study	Product uniqueness	Steering committee
5	Feasibility study	Reputation	Member capital base	Product quality	Low operating costs	Low operating costs

The Oklahoma Cooperative Extension Service
Bringing the University to You!

The Cooperative Extension Service is the largest, most successful informal educational organization in the world. It is a nationwide system funded and guided by a partnership of federal, state, and local governments that delivers information to help people help themselves through the land-grant university system.

Extension carries out programs in the broad categories of agriculture, natural resources and environment; family and consumer sciences; 4-H and other youth; and community resource development. Extension staff members live and work among the people they serve to help stimulate and educate Americans to plan ahead and cope with their problems.

Some characteristics of the Cooperative Extension system are:

- The federal, state, and local governments cooperatively share in its financial support and program direction.
- It is administered by the land-grant university as designated by the state legislature through an Extension director.
- Extension programs are nonpolitical, objective, and research-based information.
- It provides practical, problem-oriented education for people of all ages. It is designated to take the knowledge of the university to those persons who do not or cannot participate in the formal classroom instruction of the university.
- It utilizes research from university, government, and other sources to help people make their own decisions.
- More than a million volunteers help multiply the impact of the Extension professional staff.
- It dispenses no funds to the public.
- It is not a regulatory agency, but it does inform people of regulations and of their options in meeting them.
- Local programs are developed and carried out in full recognition of national problems and goals.
- The Extension staff educates people through personal contacts, meetings, demonstrations, and the mass media.
- Extension has the built-in flexibility to adjust its programs and subject matter to meet new needs. Activities shift from year to year as citizen groups and Extension workers close to the problems advise changes.

Issued in furtherance of Cooperative Extension work, acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture, Robert E. Whitson, Director of Cooperative Extension Service, Oklahoma State University, Stillwater, Oklahoma. This publication is printed and issued by Oklahoma State University as authorized by the Vice President, Dean, and Director of the Division of Agricultural Sciences and Natural Resources and has been prepared and distributed at a cost of 42 cents per copy. 1004 JA