

**New Co-operative Structures:
Capturing the Value in Value-Added Activity**

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Value-Added Activity and Co-operative Development

The midwestern United States agricultural sector is currently witnessing a renewal in the growth of co-operative enterprises. This resurgence of co-operative development has been referred to as a "Cooperative Revival" and "Co-op Fever" and has had people from all over North America visiting the region to understand how and why it has become such a hotbed of new co-operative development. What many people have discovered is that at the heart of the co-operative revival lies the so-called New Generation Co-operative.

New Generation Co-operative (NGC) is the term that has been applied to the dozens of value-added processing, limited membership co-operatives which have formed in the North Dakota and Minnesota area in recent years (Egerstrom). The new co-operatives have sprung up in virtually every sector of agricultural production in the region. They are being formed by producers involved in emerging niche markets, such as bison, tilapia, and emu, as well as by producers of traditional commodities, such as dairy, corn, and durum wheat.

The range of reasons behind the formation of the NGCs are as diverse as the markets in which they operate, but the desire to develop new value-added products is common to all of them. The driving force behind value-added production lies in the opportunity for producers to gain access to an increasing share of the consumers' food dollar. The impact of NGCs goes well beyond the farm gate, however, as people in the region believe "Co-op Fever" has been a successful rural development strategy responsible for boosting rural disposable income, employment, and population (James).

The newest generation of cooperatives in the midwestern United States represent a younger generation of farmer preparing to tackle the challenges of deregulated agricultural markets and specialized market niches. The value-added focus of NGCs is a departure from the broad objectives of commodity and input marketing which led to the previous generation of cooperatives formed during the first half of this century (Cook).

This shift in the focus of co-operative activity is not surprising given the changes occurring in agriculture. Agriculture, both in the United States and Canada, has witnessed a number of major changes in recent years. These changes include significant market deregulation, a dramatic decline in government support, and the rapid introduction of new technologies. At the same time, these changes have been accompanied by significant shifts in the attitudes of producers and consumers. These changes have touched all aspects of agricultural production, processing, and marketing. Farm size continues to grow and off-farm income has become increasingly important for farm families, even as rural communities continue to lose population. Shopping patterns are being altered as companies and governments consolidate their operations in the larger centres. The changes in agriculture have also caused a tightening of agricultural markets through the formation of increased vertical linkages and through the demand for more closely specified product characteristics. Such linkages have resulted in increased control over primary markets by outside parties and a relinquishing of control by farmers.

Farmers are responding to these challenges through two related strategies. One strategy involves direct producer involvement in value-added processing. Such involvement provides diversification opportunities for farmers, allows farmers access to a greater percentage of the food dollar, provides a nearby market for farm produce, and provides employment opportunities for rural communities. Together these characteristics mean greater sustainability for both farm operations and rural communities.

The other strategy involves using co-operatives to undertake this involvement in value-added processing. Historically co-operatives have been the natural response of farmers to rapid economic and social change. By allowing farmers to retain ownership and control, co-operatives have proven themselves capable of retaining political and economic power for their members. Only by acting together can farmers address problems of market power imbalance, undertake processing activities and vertical integration on a significant scale, or provide sufficient levels of products meeting closely specified characteristics.

What is a New Generation Co-operative?

A key feature of NGCs which distinguishes them from other more traditional cooperatives is the use of tradable equity shares that link producer capital contributions with the right to deliver product to the co-operative. In an NGC, the equity capital required for financing is raised through the sale of equity shares. The equity share plays a dual role. In addition to raising capital, each equity share sold not only entitles, but obligates, members to deliver one unit of farm product (e.g., one bushel of durum) to the co-operative. The membership equity shares create a contract between the members and the co-op that stipulates the member must deliver the contracted quantity (producers must fulfill their contract obligations with their own product or purchase product elsewhere for delivery) and the co-op must purchase the product (subject to meeting quality requirements). The price of each share is determined by taking the total amount of capital the co-op wishes to raise and dividing it by the number of units of farm product that can be absorbed by the facility.

The NGC's equity shares therefore fix the amount of product members can deliver to the processing facility and membership is restricted to producers who have purchased delivery rights from the cooperative. Regardless of the number of shares purchased by a member, however, the principle of one-member, one-vote still applies when electing a board of directors and when deciding on major cooperative policy issues. Hence, NGCs have incorporated transferable delivery rights into their ownership structure while leaving the critical cooperative features of member-control and member-use untouched.

The reason for the different membership and financial structure stems in part from the processing focus of the NGCs. In their feasibility study done prior to start-up, the NGC proponents make a decision regarding the capacity of the processing facility they will construct. Once the efficient level of capacity is decided, the amount of product members can deliver to the plant is essentially fixed. Having members contribute a significant amount of capital up-front also has benefits, including making members more committed to the co-operative and providing the co-op with sufficient equity to survive market fluctuations.

NGC - Switching Gears to Increase Farmer Returns

In 1991, a group of irrigators from Central Minnesota were looking for alternative crops that offered a better return than corn and soybeans. The area is well suited to the production of corn and peas but these crops were not grown because there was no processing facility in the area. A feasibility study showed that access to a processing plant would indeed open up production alternatives for local irrigators. Three years later, 67 Central Minnesota growers pledged 9,000 acres of sweet corn and pea production and contributed \$US 2 million in equity capital towards the construction of a \$US 9 million vegetable processing plant. The establishment of the Northern Lights Vegetable Cooperative enables producers to diversify farm production and gain "a piece of the value-added action, too."

NGC - Securing a Market Through Value Added Processing

The Dakota Growers Pasta Company is one example of the 50 New Generation Co-ops that are revitalizing rural North Dakota and Minnesota. In January, 1992, a group of North Dakota durum growers held an information meeting. Less than two years later, the Dakota Growers Pasta Company began production in Carrington, ND. In the initial stages of this process, rural and co-operative development specialists helped producers define the problem and explore solutions. A thorough study of potential business opportunities in the area indicated that pasta production was a feasible enterprise which would serve the interests of durum producers. By establishing the enterprise as a grower-owned, closed membership co-operative, producers would not only benefit from a guaranteed market and a set price for the primary product, but they would also receive a share of the earnings of the processing plant.

With a solid business plan in hand the original group of producers, with the assistance of rural development representatives, began approaching other producers to convince them of the benefits of this strategy. The drive to generate both interest and equity was an important and daunting task, as interested producers were asked to commit themselves as members of the proposed co-operative by purchasing a minimum of 1,500 shares at a cost of \$3.85/share. This represented a minimum investment of \$5,775, a large sum to cash strapped farmers. In return, members were guaranteed delivery rights of one bushel per share to the future plant.

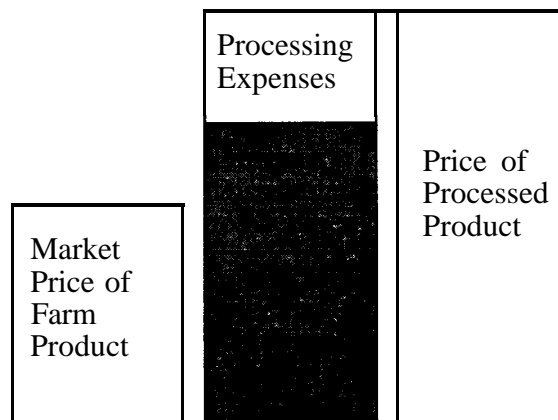
The equity drive was a success. A total of 1,040 durum producers invested \$12 million in the project, providing 30% of the \$40 million needed to build the pasta plant. These numbers translate into an average investment of \$11,538 (2,997 shares) per member, illustrating the high level of commitment and enthusiasm for the project.

Dakota Growers Pasta Company began production in November, 1993. It now produces over 50 kinds of quality-assured pasta which is marketed both under its own label and more recently through industrial accounts. With production of 100 million pounds this year, the plant is well on its way to filling its 120 million pound capacity. Dakota Growers Pasta Co. has created 180 jobs in Carrington, population 2,267.

“What will carry us through the low times as farmer-business people will be diversified income from cooperative ventures. Value-added agriculture is the ultimate hedge against low prices.”
— Mike Warner, North Dakota Producer

As an example, in the case of the pasta plant in Carrington, ND (see box) the co-operative wanted to raise \$US 12 million as equity capital. The initial share price was determined at \$US 3.85 per bushel and each share entitles the farmer to deliver a bushel of durum to the pasta plant. Farmers were given the opportunity to purchase shares at the initial price during the co-operative's equity drive. Currently, share prices reflect the returns members expect to receive from the co-operative and shares can be traded with the approval from the board of directors. There is no requirement that each member hold the same number of shares, although there is a lower and upper limit. Regardless of the number of shares purchased, the principle of one-member, one-vote still applies when electing a board of directors and when deciding on major co-operative policy issues.

Because members have financed the co-operative up-front with an equity infusion, almost all of the earnings generated by the co-operative are returned to the members at the end of the year. For example, in the pasta co-operative, members receive 60 percent of the current market price when they deliver their durum to the plant. At the end of the year, earnings are calculated by taking the total revenue generated from the sale of pasta and subtracting off the total expenses of the co-operative (see diagram). Allowance for a contingency fund is also made in determining the earnings to be distributed to members. The earnings are divided among members in proportion to the amount of durum they delivered. Future expansion of the co-operative will be financed in the same way as the co-operative was originally financed; that is, members will have to invest their money up-front through the purchase of delivery shares.



NGC - Enabling Producers to Capture More of the Food Dollar

Producers must fulfill their contract obligations with their own product or purchase product elsewhere for delivery to the plant. In the event that a producer is unable or unwilling to meet their contract requirements, the co-operative purchases the required amount of commodity and charges the cost against the member's account. The member's dividends will reflect the charge.

In Keeping with Tradition

The NGCs have some similarities with traditional co-operative structures:

- Democratic tradition is maintained through a policy of one member, one vote.
- Excess earnings are distributed among the members as dividends.
- The Board of Directors is elected from the membership by the membership

Many of the NGCs also offer preferred shares to enable contributions from the community or other interested parties. Holders of preferred shares do not have voting rights and there is a limit on the amount of interest paid on these stocks (in North Dakota the limit is legislated at 8%). This policy lets communities support the project while keeping control in the hands of the producer members.

It is the responsibility of the board to set the co-operative's strategy, goals, and objectives, and to hire a manager. The manager, in turn, is responsible for conducting activities to achieve the goals and objectives of the co-operative, evaluating performance, and reporting to the board. The board and management have a collective responsibility to report to the membership. The success of any co-operative is therefore directly related to the confidence the membership places in its elected representatives and management team and the ability to maintain continuous communication between all three parties.

The membership and financial structure of NGCs provides members with a higher degree of personal ownership and a greater degree of commitment to the organization than what is typically the case in more traditional co-operatives. This commitment plays a key role in allowing the co-operative to meet its objectives of establishing a profitable and efficient agribusiness that captures more of the food dollar and provides a market for agricultural commodities.

The Process

The success and proliferation of New Generation Co-operatives in North Dakota and Minnesota raises the question as to whether NGC formation follows a definable process. Although these co-operatives provide excellent examples and inspiration, there is not one recipe for success. There are several factors that are considered critical to a successful venture and the process itself varies with each situation. Flexibility to deal with diverse groups, commodities and communities is crucial. The process outlined below should be used as a guideline and not a rule book. Each situation will require a variation in steps and the process is often circular rather than linear.

The process begins with a producer group realizing they face a common problem or a perceived opportunity. The group may proceed through the next stage on their own or enlist the help of a development agent or coordinator. If a coordinator's help is enlisted, this person works with the group to define the problem, assess resources, explore options, resolve conflict and enhance cohesion. The presence of this outside agent can provide the group with linkages to resources and information, both of which are useful in the achievement of their goals. In the case of the Dakota Dairy Specialties Cooperative (see box), representatives of the existing cooperative requested the assistance of a facilitator specializing in co-operative development.

Dakota Dairy Specialties Cooperative

When members of the Hebron Creamery Cooperative grew dissatisfied with their treatment by the larger dairies, they called in a facilitator from the Center for Cooperative Development in Mandan, ND, to advise them of their alternatives. The decision to dismantle the existing cooperative and form Dakota Dairy Specialties Cooperative was the result of a long and at times, difficult process. The facilitator was present at every meeting, helping the group to define the problem, explore the alternatives, resolve conflict, encourage the leadership and involvement of the membership, and to ease the transition from the old structure to the new. The facilitator continues to be available to the group to assist in the resolution of problems that arise.

Once the group has a clear understanding of the situation and have determined that they will be able to work together, they undertake a feasibility study. A well done, comprehensive feasibility study is one of the key elements of success. Those with knowledge of the industry, the resources and the market explore a range of possibilities and present several options to the producer group. The producers then have the information to help them make a sound decision on whether to proceed with the venture, and how best to go about it.

If the group decides to proceed, a detailed business plan is developed for the co-operative. The business plan is critiqued and adjusted by financial institutions and industry experts until all are satisfied that the plan provides an appropriate direction for the venture. Because the objectives of NGCs are to create a viable business to increase employment and diversify the economy, a solid business plan is considered a crucial component of the process.

Next is the critical step of conducting an equity drive. The producer group, rural development representatives, and others meet with producers to convince them of the advantages of becoming members and purchasing delivery right shares. This is a critical step -the venture will not proceed unless it has the support and commitment of enough members to generate a reasonable chance of success. The general rule of thumb is to collect 50% of start up capital through the sale of shares. (This can be lowered to 35% or 40% through risk reduction strategies such as feasibility studies, marketing contracts, turn-key cost estimates, quality management and others.) If the co-operative is unable to solicit this much support from producers, financial institutions are unlikely to view the venture as a reasonable risk and will be reluctant to lend further capital. As well, sufficient product must be committed to ensure the plant runs efficiently. Once enough members are committed the co-operative, preferred shares can be offered to other community groups or institutions. Remaining capital requirements are raised through debt financing.

Elements Critical to the Growth of NGCs

The process at work in North Dakota started with the development of a comprehensive and focused rural development strategy, Growing North Dakota. This strategy established the infrastructure which provides the resources and the machinery critical to development. Representatives of various organizations in the state, created a network of support, information sharing, and enthusiasim. Government and quasi-government organizations do not drive the development, they support it. The impetus for development comes from producer groups and the government plays the role of advocate, encouraging a positive attitude and supporting projects by helping to remove some of the barriers. This

NGC - Taking Advantage of New Opportunities:

Since 1993, the North American Bison Cooperative has operated a \$1.6 million bison processing plant in New Rockford, North Dakota. In this town of 1,604, the 10 new jobs at the plant have made a significant difference. The Cooperative has 180 members located across the Midwest States and in Saskatchewan and Manitoba. Transportation costs are pooled among members so that those located at a distance to the plant are not penalized.

This year, the NGC will process 2,700 head. The product (boxed, fresh meat, individual servings and specialty products such as Jerky, Bison Bacon, and sausage) is marketed through the store front and shipped to East Coast restaurants and European markets. Demand for bison meat is growing steadily as a more health conscience population discovers the unique lean product. The co-op now slaughters and processes 20% of US bison and is confident it is well positioned to meet future market opportunities.

NGC - A Solution to Low Commodity Prices

In the past, dairy producers in southwest North Dakota, sold their milk to the Hebron Creamery Cooperative, which in turn sold it to larger cooperatives who dictated the price paid to producers. Returns to southwestern dairy producers were lower than average, as shipping charges to finishing markets were levied. In an effort to gain control over their product and increase the price producers receive, dairy producers formed the Dakota Dairy Specialties Cooperative.

The results of an extensive feasibility study indicated that specialty cheese production was a profitable venture given the regions resources. Dakota Dairy Specialties has replaced the Hebron Creamery and will be building specialty cheese production facilities as an addition to the former creamery building. Plans to introduce premium ice cream to their product line are also underway.

Sixty dairy producers have joined the cooperative by purchasing shares which give them the right to deliver to the cooperative, providing a stable market for their milk. They will be paid according to the market price for milk and will share in the profits of the dairy. Board members see the new generation cooperative structure as a way to ensure member loyalty and a high quality production.

environment creates ideal conditions for the growth of many different kinds of industry and enterprise development, including New Generation Co-operatives.

Within this environment, many factors contribute to building viable, sustainable enterprises. Facilitators and/or co-operative development specialists work as project coordinators and are an important link between producer groups and outside resources. They meet with producer groups to offer ideas and encouragement while guiding them through the process.

Motivated, determined producers are the most important element in the success of New Generation Co-operatives. Members must be willing to set aside egos and individualism to work on collective solutions. A core group of producers supportive of the New Generation Co-operative will spend many hours exploring options, arranging for feasibility studies and business plans, talking to other producers, and dealing with financiers as they lead the project through to completion. If this core group is present and highly motivated, they will draw the support and commitment of other producers and economic development agents. Without this group driving the project, the efforts of others to create development will be unsuccessful. The environment provided by the network and the catalyst provided by the coordinators make development possible. However, enthusiastic producers as project champions make development a reality.

Those working to establish NGCs use practical tools: feasibility studies, business plans and equity drives. Creating viable enterprises which will continue to provide benefits to producers, employees and communities for the long term is the real objective of exploring NGCs as a development strategy. Therefore, it is crucial that a thorough feasibility study be conducted to determine the most

"A word of caution may be appropriate in the midst of all of the enthusiasm. Combining the cooperative form of business organization with the concept of adding value to farm products through further processing is NOT an automatic formula for success."

**— Brent D Bostrom, Chair,
Doherty, Rumble & Butler's
Cooperative Law Department**

appropriate response in any situation. A solid business plan is vital in the promotion and development of a business. When all the other factors are in place, the enthusiasm and motivation will fuel a successful equity drive. Producers and development agents committed to the success of the project and armed with a solid business plan based on a well done feasibility study will generate support and encourage the membership required for start up.

There is no fool-proof recipe or blueprint for the creation of NGCs or indeed for sustainable development. Therefore, the strategies and the people must be open and flexible. The process, the options and the decisions will be different in each situation. Nor are NGCs always the best alternative. NGCs will only be successful if they are chosen by producers as the preferred organizational form.

The number of successful NGCs in North Dakota and Minnesota creates the temptation to view this strategy as the answer to all the problems of rural areas. However, simply applying the NGC model will not turn bad ideas into good ideas, and will not automatically create viable businesses.

George Sinner is vice president of public and government relations for American Crystal Sugar Co. which is the oldest of the new generation co-operatives (21 years). Sinner reminds us that when considering co-operative business structures, we should emphasize the five Cs that are regarded as the building blocks of successful co-operatives. "Putting **capital** together to achieve a purchasing or marketing advantage. Allowing members to exercise **control** over the way they are treated in their contracts and markets. **Communicating** to make sure everyone in the organization understands what's happening. Establishing **continuity** with the past. Sustaining and improving the **community**."

Can This Work in Saskatchewan?

A focused rural development strategy and NGC formation have had a positive impact on the economies of North Dakota and Minnesota. People have a new, positive attitude, resulting from the realization that they can take charge of their lives and influence the future of their communities. Can we expect a similar atmosphere on the Canadian prairies?

Saskatchewan has been through a period of drought and low commodity prices. Farmers have diversified production into many unique commodities such as bison, elk, and borage. Vegetable and small fruit production far exceed traditional levels. Many of these commodities are reaching a critical stage of production. The profits to be made in the niche markets served by small scale production may soon be eroded by over-supply. As traditional structures and institutions change or are threatened by new regulations under GATT and NAFTA, producers are looking for other marketing options. The loss of the

Potential Pitfalls for New Cooperatives

- Lack of a clearly identified mission
- Inadequate planning
- Failure to use advisors and consultants
- Lack of member leadership
- Lack of member commitment
- Inadequate management
- Failure to identify and minimize risks
- Overly optimistic assumptions
- Not enough money
- Inadequate communication

— Brent D Bostrom, Chair,
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Crow benefit is also causing producers to look for new markets. Researchers have suggested the Saskatchewan economy could be stabilized through reduced reliance on the export of raw commodities. Establishing processing facilities in the province would create jobs and keep more of the food dollar in the local economy.

In this atmosphere of change and opportunity, it is important everyone have knowledge of a wide range of alternatives. Although they are not the appropriate response in all situations, NGCs have the potential to provide opportunities otherwise not possible. NGCs are one way of providing value-added activity in Saskatchewan. Choosing a producer-owned structure over a corporate structure gives producers access to a larger share of the earnings generated from such activity and also keeps these earnings circulating in the local economy. Local owners have a large stake in the success and longevity of the enterprise. NGCs are more likely to stay in the community and will be less tempted to move to take advantage of tax breaks or lower operating costs.

NGC - Fishing for Information

The Dakota Aquaculture Cooperative and the North American Fish Farmers Cooperative is an information and marketing organization that serves 150 members across five states by providing research and demonstration facilities. The marketing arm develops markets and coordinates quality and supply. It supplies on-farm technical advice, fingerlings, feed and will soon offer tanker pick-up and delivery.

NGC - Quality and Uniformity: The Virtual Feedlot

Central Dakota Cattle Association, Maddock, North Dakota, supervises and finances the backgrounding of cattle on the farms of its members. The co-op pays producers 95% of market value and supervises the feeding and care to produce uniform lots of cattle for sale to large feedlots for finishing. Pooling larger lots gives the group market power that individual producers can not attain.

NGC - Gaining Control

Strong competition from the well organized fruit co-operatives in Washington and Oregon put Minnesota apple producers at a disadvantage. To gain some market power, 30 apple growers are forming a cooperative. The cooperative will guarantee retailers a steady supply, uniform quality and packaging.

NGC - Sweet Success

American Crystal Sugar Company has three plants in Minnesota and two in North Dakota. In operation since 1972, American Crystal produces 20 million hundred weight of sugar per year and pays out \$290 million in beet payments. All sugar beets grown in the area are processed locally at American Crystal or other sugar beet co-operatives. American Crystal was the first of the NGCs and has served as a model for NGC formation and development.

NGC - Co-operation Among Co-operatives

In the late 1980s, four grain elevator co-ops near Renville, Minnesota merged to form the Cooperative Country Farmers Elevators. Also in the Renville area, corn producers formed an NGC, ValAdCo, to add value to their corn by feeding it to hogs. With a total investment of \$US 17 million, ValAdCo houses 8,750 breeding sows. The large scale of this farrow-to-finish operation decreases the production costs per hog so that the co-op is able to pay dividends to its members. Other grain producers in the area formed Midwest Investors to transform grain into eggs. One million laying hens are housed in \$US 9 million barns on the outskirts of Renville. The co-op markets eggs through a joint venture with a private egg company. Future plans include a plant to process eggs for use in the food industry, moving producers further up the food chain. To supply their own specialized feed mixes for hogs and chickens, ValAdCo and Midwest Investors joined with Coop Country Farmers Elevators to form United Mills. Coop Country assists the new co-op ventures and its farmer members by an expansion of services to provide accounting and administration services to the new coops and the introduction of a manure management program making manure part of the fertilizer mix the co-op sells to its members. The ability to utilize wastes through the manure management program helped the livestock operations meet the environmental standards of the pollution control board.

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