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**New Generation Co-operative
Development in Canada**

MURRAY FULTON

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participation



UNIVERSITY OF
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Centre for the Study
of Co-operatives

New Generation Co-operative Development in Canada

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Contents

Introduction and Overview	1
The Context for New Generation Co-operatives	2
The Transformation of Agriculture and the Rise of New Generation Co-operatives	3
The Benefits of NGCs	5
What NGCs Cannot Do	9
NGC Development in the US	10
NGC Development in Canada	14
The Adaptation and Evolution of NGCs	17
Challenges for NGCs	20
Conclusion	22

New Generation Co-operative Development in Canada: An Overview

Introduction and Overview

New Generation Co-operatives (NGCs) are a relatively new phenomenon in Canada. In contrast to the US, where hundreds of NGCs have formed, involving thousands of farmer-members and millions of dollars of investment, NGC development in Canada has been slow. The purpose of this paper is to provide some background on why NGCs have developed at this particular point in the history of agriculture and why they need to be encouraged. The paper explores some of the factors that have influenced their development in the US and examines why NGC development has been slower in Canada. The paper also discusses ways in which the model is changing and evolving and some of the challenges NGCs are currently facing.

The main conclusions of the paper are as follows. First, NGCs have emerged as a new organizational form in large part as a response to the ongoing transformation of agriculture. NGCs have also addressed some of the internal problems faced by traditional co-ops, although this issue is not examined extensively in this paper. While agriculture will survive without NGCs, it is also clear that NGCs—like their co-operative counterparts in earlier periods of the twentieth century—have the potential to improve the performance of the agricultural system. NGCs will address market failures, they will develop new and assured markets for agricultural products, and they will create employment and economic activity in rural areas.

NGCs have developed in the US in large part because of the significant amount of development assistance they have been given, whether this be in the form of development officers who work closely with producer groups, funding for business plans, or access to credit. This type of assistance has not been present in Canada and is likely the single largest factor in explaining the lack of NGC development in this country.

The NGC model is not static, but is adapting and evolving. Despite the changes occurring in the model, a number of features—such as high capital investments, delivery rights, and a clear sense of member ownership and control—are critical to its successful operation. NGCs are also facing a number of challenges, including issues around intergenerational transfer, the nature of delivery rights, the need to work with other NGCs, and new models that can provide farmers with access to intellectual property.

Much is known about NGCs, how they work, and what is needed for their successful development. NGCs can play an important role in Canadian agriculture, keeping this sector prosperous, innovative, and efficient. Unless some deliberate effort is made to develop them, however, their potential will remain unrealized. It is time to start putting what is known about NGCs into action. While additional research is required, this research is not about the basics. The basics are known and they can and should be developed and built upon.

The Context for New Generation Co-operatives

Historically, agricultural and rural co-operatives in both Canada and the US have emerged in waves. The co-ops formed during these previous waves have played an extremely important role in keeping the agricultural sector and rural areas healthy and prosperous. The first wave occurred during the early part of the twentieth century, when agriculture and agricultural markets were in their infancy. Farmers formed co-ops in reaction to the oligopolistic practices of input suppliers and farm-product handlers and processors. Co-operatives were one of the mechanisms by which greater competition was introduced into the market. Indeed, co-operatives have often been billed as the “competitive yardstick.”

A second wave of co-op formation occurred during the 1930s and 1940s, largely in response to a lack of service provision—whether it was in the financial, retailing, telephone, or power-generation sectors—that occurred as investor-owned firms turned their attention to more lucrative urban markets. Once again, co-operatives played a key role in ensuring the vitality of rural areas.

The current wave of co-operative development, largely confined to the US, is in part a response to the transformation underway in agriculture. It is also a response to some of the internal challenges that co-operatives are facing. This wave can be expected to provide a similar range of benefits to farmers and rural residents. Like the co-ops in the first wave, NGCs will provide important competition in agricultural markets. As well, they offer a way of vertically integrating and of using the information on product quality that farmers possess to enhance their economic returns. Like co-ops formed during the second wave, NGCs will play a role in providing economic activity in rural areas. NGCs are also forming for other reasons, which will be examined in a later section.

The Transformation of Agriculture and the Rise of New Generation Co-operatives

Agriculture is undergoing a major transformation. Production is no longer concerned with only generic commodities, but is increasingly focussed on differentiated products. In keeping with less emphasis on commodities and more emphasis on products, decisions made by firms in all segments of the industry are becoming interdependent, and firms are more frequently being asked to deliver products of a consistent quality at an appropriate time. As a consequence, trade in agricultural output moves less and less through formal markets. Instead—as vertical co-ordination and integration increase—more and more product transfer occurs through contracts, or internally within companies. These changes mean that traditional price and production risks are replaced or augmented by risks surrounding relationships. Hazards around food health and safety are also becoming more important. Finally, production at all stages of the industry is more

capital intensive, and international trade—often among multinationals—is becoming more important.

A significant consequence of this transformation is a shift in the source of power and control. There are two key points of power in agriculture. The first derives from knowledge of consumer demand. Those firms that are close to consumers and have unique knowledge of the specificity of demand are able to transfer this power through the food supply chain. The second power point lies with the suppliers of raw material, especially with those whose input in the production process is not easily substitutable. The inputs with the least amount of substitutability are the genetic materials. The current transformation in agriculture is characterized by power shifting away from the farm production sector and towards the retail and genetic materials sectors.

The process of increasing specialization and vertical co-ordination or contracting also means that producers experience a loss of both independence and control. Production and management decisions once determined solely by farmers according to market indicators are increasingly influenced and co-ordinated by interdependent relationships with other actors along the supply chain. Since power and control are dictated by information and are, therefore, greatest at either the retail stage or the genetic-input stage, producers will experience declining power and control. And since power involves the ability to transfer risk to other actors, declining power will also result in increased producer risk.

These changes are important factors in the emergence and subsequent development of New Generation Co-operatives in the US over the past ten to fifteen years. US producers have decided that they need to be active participants in the new agriculture—that they need to take a leading role in integrating production and processing, and that they need to capture the benefits from a better focus on product quality. NGCs are viewed by farmers as one way in which they can maintain some power and control within the agri-food system.

In embracing NGCs, farmer-members have decided that they are going to address agricultural transformation by adopting the key characteristics of the new agriculture in organizations that they own and control. Indeed,

the key structural elements of NGCs are closely aligned with the main characteristics of the new agriculture. The specific product focus and the delivery contract of the NGC, for instance, mirror the emphasis on differentiated products and contractual linkages that characterize this agriculture. The vertical integration inherent in the co-operative allows for greater interdependence in decision making by participants in different parts of the agri-food chain. The up-front purchase of delivery shares ensures a high degree of commitment by both the co-op and each member, thus reducing concerns about relationship risk. In short, NGCs have precisely the characteristics that are required to operate in a transformed agricultural environment.

The Benefits of NGCs

NGCs are clearly providing benefits to their members. The widespread adoption of NGCs—thousands of farmers in the US have become members of NGCs, investing millions of dollars in the process—indicates that farmers perceive significant benefit from investing in these types of organizations. NGCs are also providing employment in rural areas and assured markets for agricultural products—particularly those that are costly to transport or are of a niche nature. Of course, the enterprises created have not all been successful. The success rate has been good, however, particularly in comparison to traditional business start-ups.

Market Failures

NGCs provide more than just a personal benefit to the producers who form them. As with the co-ops that emerged during the first two waves of co-operative formation of the twentieth century, NGCs are playing an important public policy role, which centres around the ability of co-operatives to address market failures.

Market failures occur when the market mechanism—left on its own—fails to provide the most efficient outcome. One example is monopolistic and oligopolistic pricing practices that lead to market prices that deviate significantly from the competitive norm. A second example occurs when companies fail to provide a good or service to a region with relatively low

demand because another more populous region can be more profitably served. As noted above, both these types of market failures were present in agriculture during the early and mid-twentieth century.

Since co-ops take considerable time and effort to get up and running, members would only consider forming a co-op in a situation where there were significant benefits to be had. In the absence of market failures, therefore, co-ops would generally not be formed, since the market mechanism would be supplying goods and services in an efficient manner. When market failures are present, however, a role for co-operatives emerges. Indeed, the two waves of co-operative formation during the twentieth century can be seen largely as an attempt by farmers and rural residents to address market failures. The billing of co-ops as the competitive yardstick is a direct reference to the role that co-ops play in this context.

Public Policy Role

Governments have provided support for co-operative development because of the public policy role that co-ops play. The USDA's decision in the 1930s and 1940s to support the development of rural electric and telephone co-ops, for instance, was based on the idea that co-ops could address the market failure—the lack of service provision—that was believed to exist in these sectors. Co-ops in the US were also specifically exempted from anti-trust legislation and were given tax breaks because of their role in creating more competitive markets.

Co-operative development requires government support because co-operative organizations face unique challenges that stem from their collective nature. This collective nature creates free-rider problems: while each individual benefits from the organization being in place, no single individual has the incentive to undertake the actions necessary to create the organization. Creating collective organizations requires the co-ordination of the activities of many individuals and the development of the assurance among a critical mass of people that the others in the group will work together. While this co-ordination and assurance is difficult for the members of a group to create and foster, it can be done by outside development agents, who can also reduce some of the other transactions costs such as

the development of a basic organizational model that can be used over and over again.

Like their predecessors, NGCs also have a public policy role in addressing market failures. In some cases, these failures are the same as those addressed by traditional co-ops. American Crystal, for instance, was formed when a private sugar-beet processing company decided to leave the Red River Valley area because more profitable opportunities existed elsewhere. The durum wheat market has often been described as being oligopolistic, and the formation of Dakota Growers Pasta must be seen at least partially in this light.

Relationship Risk

The new agriculture also creates a new source of market failures, some of which centre around asset specificity and relationship risk. Relationship risk—the possibility that the firm with which a farmer has contracted does not honour the contract—is of particular concern when the assets owned by the farmer are highly specific in nature. Highly specific assets have an extremely low value in their next best use. Thus, a facility that could only be sold for thirty cents on the dollar would be said to be a highly specific asset, and producers with such assets typically have few options. If they are unhappy with the price they are receiving for the product they are producing, for instance, they have little choice but to take that price, since selling the asset and getting out of production generates very little in returns. Since farmers know that they will lack options if they make the investment in highly specific assets, they may decide not to make the investment. As a result, what might otherwise be profitable investments are not undertaken.

The formation of NGCs and the signing of delivery rights is a way of reducing relationship risk and of ensuring that investments are undertaken. The formation of an NGC creates an organization that the members themselves control; members believe that the co-op will honour the contracts, since they, the members, control the organization. Each member also knows that the other members will honour their contracts, since each member has little option but to do so. The result is that relationship risk is reduced—the co-op can be expected to be there to process the product and the members can be expected to supply it.

The NGC thus becomes an organizational mechanism whereby the production of the farm commodity and the production of the processed good can be carried out together. The formation of the North American Bison Cooperative is an example of a co-op formed to address relationship risk. In the absence of the co-op, most farmers would be reluctant to invest in bison without an assurance that a processing plant would be in place. Similarly, investors would have been unwilling to invest in a processing plant without bison production nearby. The formation of an NGC provides the assurance necessary for both activities to take place.

Of course, there are other ways of getting this investment undertaken. One way would be through vertical integration—a private company building a bison processing plant could vertically integrate backwards into bison production. It is unlikely, however, that the private company would be able to raise bison as efficiently as independent producers, who have a better knowledge of the process. Thus, the formation of the NGC can be seen as a way of reducing relationship risk, while at the same time ensuring high degrees of production efficiency.

Information

The bison example illustrates another source of market failure that is important in the new agriculture—information. Producers possess knowledge of key aspects of production and product quality that are becoming increasingly valuable in the market-place. In a number of situations, standard market and contractual mechanisms may not provide sufficient incentives for farmers to use this information efficiently. NGCs—by creating a close linkage between the incentives of the producer and those of the processor—are a mechanism whereby this information can be used more effectively.

Power and Control

To conclude, NGCs are providing farmers with some degree of power and control in the agri-food system. This is an important check and balance, since without it the system is more likely to lack the stability required to operate effectively. Historically, co-ops—in addressing market failures—have helped to reduce the excesses of the market such as high input prices

and lack of service. These reductions have not only provided material benefits to farmers and to society in the form of better prices or service, but have also provided farmers with a sense that the industry is at least partially responsive to their needs. Farmer involvement in the industry has also led to greater innovation. In Canada, for instance, farmer involvement in the grain industry led to the creation of inland terminals and protein grading. In the future, producer ownership of certain segments of the market may be a way of maintaining or increasing consumer confidence in the food supply. Not only may farmers be viewed as more trustworthy than the multinationals, farmer ownership of parts of the food system can create incentives for the better use of the knowledge that farmers possess regarding product quality and safety.

What NGCs Cannot Do

While NGCs can be expected to have a beneficial impact on agriculture, it is important to stress that NGCs are not the solution to all the problems currently facing the industry. NGCs cannot, for instance, deal with the long-term income issue that has plagued agriculture for the last century and will continue to do so for the foreseeable future. Agricultural incomes will always be low for a portion of farmers—specifically those who are unable to adopt technology fast enough to lower their costs to keep pace with the falling price of agricultural products. The price of agricultural products, of course, is continually being pushed down because of the adoption of technology.

NGCs do not address this fundamental structural issue. Indeed, they may even exacerbate it in some instances. Not all farmers are either psychologically predisposed to make an investment in a value-added enterprise or to produce according to the dictates of the NGC. Thus, at best, NGCs only represent a solution for those farmers who are willing to try to stay ahead of the transformation underway in the industry. Since these farmers are often the same ones who attempt to stay ahead of the technology curve, the income problem is unlikely to be ameliorated.¹

1. As an example, survey evidence shows that NGC members tend to view themselves as being in the food system rather than farming, and see NGC co-op investment as having higher returns and higher risk than other investment opportunities.

Nor are all farmers financially able to make an investment in an NGC. In fact, investment in an NGC requires that farmers have access to more capital, not less, and since access to capital for their farming operations is a problem for many producers, access to capital for NGC investment is also likely to be problematic. While NGC development has clearly been influenced by government policy in the US, this influence has largely been viewed in terms of development assistance (see the discussion elsewhere in this paper). One issue that has not been looked at in the literature, but which bears investigation, is the degree to which payments to US farmers under the various Farm Bills have enabled them to make their investment in NGCs, thus providing a further, albeit indirect, link between government policy and NGC development.

While NGCs cannot address the larger structural problem in agriculture, it is nevertheless a proven model that has provided benefits to producers and the rural communities in which they live. Agriculture will survive without NGCs, but if history is any indication, the overall performance of the sector will be reduced in their absence.

NGC Development in the US

The development of a large number of NGCs in the US over the past ten to fifteen years has led observers to inquire into the causes of this phenomenon. A number of factors have been identified as reasons for their success, including the common ethnic (i.e., Scandinavian) background of farmers in Minnesota and North Dakota, where NGCs first started, the long experience with co-operatives in these two states, the success of the early sugar co-operatives that were structured as NGCs, and state governments that were not hostile to co-operatives regardless of their political affiliation. Taxation regulations and the Capper-Volstead exemption from antitrust legislation have also clearly influenced the selection of the co-operative model (and/or the Limited Liability Company (LLC) model) over other organizational forms.

While the factors listed above help explain the organizational form taken by the farmer-owned enterprises that have developed—i.e., the choice of a co-op over some other organizational form—they do not ex-

plain why producers formed farmer-owned enterprises in the first place. Part of the reason lies in the economic and social conditions in which Minnesota and North Dakota farmers found themselves during the late 1980s and the early 1990s. Simply put, the economic hardships of this period and the continuing decline of rural areas led farmers and rural residents to search for solutions that would encourage economic activity.

While this was important, however, it was not the sole factor behind the development of farmer-owned enterprises. Similar economic conditions existed in other states during the same period and in Canada at a somewhat later date, and yet farmer-owned enterprises did not form in nearly the same numbers in these other geographical areas. This pattern, however, is changing. In the US, NGCs or NGC-style organizations are springing up in all states, with significant concentrations in Illinois, Wisconsin, Michigan, South Dakota, Iowa, Missouri, Kansas, California, and Washington.

An important factor responsible for both the formation of farmer-owned enterprises and their subsequent incorporation as co-operatives is the development support provided by state governments and other co-operative organizations (e.g., the co-operative banks) in Minnesota and North Dakota, and now increasingly in other states. The federal government, through the United States Department of Agriculture (USDA), has also played an important role.

Development support in the US takes a variety of forms. There are development officers who work closely with groups that are exploring options, while other support comes from resources provided by government (both federal and state) for feasibility studies and business-plan development. Financial institutions that lend specifically to co-operatives and their members provide additional support. It is important to note that the mix of development support differs—often quite substantially—from state to state. Thus, while support is critical, it is not monolithic in form.

The Center for Cooperative Development in North Dakota is a good example of support provided by development officers. The center has one to two people working full time assisting producer groups in the development of new business opportunities. Interestingly, the focus of the center is

not solely co-operative development, but is rather rural business development, and it is largely this concentration on developing rural businesses that has led to the development of farmer-owned enterprises. These enterprises, in turn, have chosen the co-operative as their organizational form largely because of some of the inherent advantages it has over other forms. While tax advantages, antitrust exemptions, ethnic considerations, and previous co-op experience have resulted in a preference for co-operative enterprises, these factors do not appear to have been the root cause of the development. The root cause appears, rather, to be the financial and development assistance provided to producer groups.

Funding for the North Dakota center also illustrates the diversity of development support that is provided. The center is funded in part by the existing co-ops in North Dakota (specifically the telephone and electrical utility co-ops) and in part by the USDA. In 2000, the USDA contributed \$6.5 million to support a network of thirty development centers across the US, of which the North Dakota center was one.

Both state and federal governments provide support in other ways, such as for feasibility studies and business plan development. As an example, the USDA announced on 25 June 2001 the approval of twenty-eight value-added, agricultural-product, market development grants totalling nearly \$10 million. All of the recipient organizations were 100 percent producer owned, whether through a co-op or an LLC. State governments also provide funds for the development of business proposals.

The \$6.5 million contribution to co-op development centers and the \$10 million in grants is only a portion of the total federal budget for co-operatives and co-operative development. Examples of other support include funding research into co-operatives and making farmer-owned businesses that purchase value-added processing facilities eligible for a tax advantage. The USDA is also currently considering a \$150-million loan guarantee fund for NGCs.

Still other support comes from the financial sector, whether it is the state banks or the co-operative banking system, which stands ready to provide not only financing, but also support in proposal development to ventures with a strong potential. The most important of the groups that

provide this type of support is CoBank, part of the Farm Credit System, which consists of six regional Farm Credit Banks along with CoBank. For the most part, the Farm Credit Banks offer financial services to individual producers, while CoBank focusses its attention on financing rural businesses, such as agricultural co-operatives and utility companies. CoBank provides debt financing for agricultural co-ops, as well as funding for farmers to make their equity investments in the co-op.

One of the important factors in the support is the wide variety of organizations that are involved. Development support is not seen as the purview of only one organization, but is rather shared by a number of groups. Rural utility co-operatives and associations of existing co-operatives, for instance, are extremely supportive of NGCs since their own survival depends on maintaining a healthy rural economy. As an example, North Dakota's Association of Rural Electric Co-operatives and Association of Telephone Co-operatives have partnered with Farm Credit Services, the North Dakota Farmers Union, the North Dakota Credit Union League, and other co-operatives to form the North Dakota Co-ordinating Council for Co-operatives (NDCCC).

The NDCCC played a significant role in the creation of the Center for Cooperative Development, mentioned earlier. The center is financed mainly through private funds, with some financial assistance from the USDA's Rural Development Administration, and supports a Rural Development Program Director and a Co-operative Development Specialist. Both individuals are key players in providing encouragement, technical assistance, and business advice to producer groups, and have been directly involved in the establishment of many NGCs in the region. In Minnesota, the Minnesota Association of Co-operatives is a vital source of information about NGCs to the agricultural community. The Ag Utilization Research Institute and the state universities of North Dakota and Minnesota actively conduct research on the subject of co-operatives. Knowledge about NGCs is also shared with farmers through university extension services.

The result is a network of development support that creates an atmosphere and environment much different from what exists in Canada. On an NGC bus tour to North Dakota and Minnesota in April 1996, one of the

participants remarked, “Am I missing something, or is there not just a lot more support for co-operatives here than in Saskatchewan?” This observation came from somebody very familiar with co-operatives in Saskatchewan, who was able to compare what he was seeing and learning on the tour with what he knew was happening in his own province.

NGC Development in Canada

In contrast to the US, NGC development in Canada has been slow, with no more than half a dozen NGCs formed in any single province. There are a number of reasons for this. Part of it has to do with the developmental direction taken by farmer-owned enterprises, while another part lies in the decisions made by farmer-owned enterprises as to which organizational model they would like to follow. The rest of this section outlines the major reasons for this lack of development, using examples from Saskatchewan to illustrate the points.

The first point is that the lack of development of NGCs is not to be confused with a lack of development of farmer-owned enterprises. Over the past five to ten years there has been substantial investment by farmers and rural residents in agricultural-based enterprises. Examples of this investment in Saskatchewan include inland grain terminals, pulse-cleaning plants, and community hog barns. These investments, however, are qualitatively different from the majority of investments that have been made in farmer-owned enterprises in the US. Inland grain terminals, cleaning plants for pulse crops, and community hog barns involve much less processing and value-added activity than is the case with NGC investments. As well, these enterprises typically have not concentrated on product differentiation and using information in the same way that NGCs in the US have done. The reason for this qualitative difference will be returned to later.

For a number of reasons, the organizational form chosen for the farmer-owned enterprises that have been formed in Canada has not been the co-operative. One of the reasons is that a number of these enterprises—the inland grain terminals, for example—were established because farmers did not feel the existing grain handling industry, which was dominated by co-ops, was active enough in reshaping itself. Many of the farmers who

spearheaded these efforts chose a structure that was explicitly not a co-operative, since the perception was that co-operatives were not as able to effectively restructure the industry.

Many of the developments had also begun before the NGC concept was widely known in Canada. As was the pattern in North Dakota and Minnesota, the formation of farmer-owned enterprises typically occurred around a development model that was applied over and over again. This pattern reflected the fact that a common group often facilitated the development of new projects and that once a model was developed, the transactions costs of using it again were low—farmers had greater familiarity with the model, the initial development costs had already been incurred, and business professionals were familiar with the model. In the case of the inland terminals, the Ernst and Young consulting firm played a key role in the development of a model that was then used with a number of client groups. In the case of hog barns, Quadra—an early promoter and operator of community hog barns—followed by other players such as Saskatchewan Wheat Pool, developed a model that was used repeatedly in different communities.

Legal and taxation issues have also been important in raising the transactions costs so that co-operatives are not being selected as the development model. On the taxation side, groups often began their operations as limited partnerships, a legal form that allowed the initial costs of development to flow back to the individual investors, where costs could be used to offset personal income. While it may be possible to roll a limited partnership into a co-operative structure, the ease with which this can be done in a corporate structure has made that form more attractive. On the legal side, many of the enterprises that have been formed wished to involve other people besides farmers as investors. The traditional co-operative structure makes it difficult, if not impossible, to have nonfarmers as voting investors. This issue has been at least partly addressed with the passage of new legislation in Manitoba and Saskatchewan (and pending in Alberta) directed specifically at NGCs.²

2. New legislation for NGCs was passed in Alberta on 31 May 2001, although it will not come into force until 2002.

Finally, some specific characteristics of the NGC structure has resulted in it not being chosen as an organizational form. In a number of cases, for instance, farmers have indicated that they do not want to lock themselves into delivery contracts with a co-op, since they believe this limits their options to achieve better prices and terms elsewhere.

As outlined above, the general perception is that farmer-owned enterprises in western Canada have generally been less focussed on value-added activities than have their counterparts in North Dakota and Minnesota. There are a number of reasons for this pattern of development. The Crow Rate, with its subsidization of primary product exports, has been partly responsible for engendering the belief that concentrating on primary production rather than on processing was the best way to create value.

Another important factor is the lack of development support for farmer-owned processing activities. The wide support for development in the US (see the previous section) is simply not present in any province in the country. While the co-operative sector has supported co-operative development as a principle, it has provided few resources to this activity outside of the development activities it wishes to pursue on its own. While some co-operative organizations—such as credit unions—have expressed an interest in development activities, none have felt that they had the capability to get into this area on their own.

In Saskatchewan, the government has provided some development support through the Department of Economic and Co-operative Development, although the support has usually been generic in nature, rather than being targeted specifically at the needs of farmers and others who would like to invest in value-added activities. Saskatchewan Agriculture and Food also provides support for feasibility studies and business plans through their ANGen program.

Until last year, however, this support existed in a vacuum. There was no sense that a network of development support existed. As mentioned above, the professional community (e.g., lawyers, accountants, business consultants) was largely unaware of the NGC model and would often discount it as a business organization. As discussed, this lack of development support is important because research shows that farmer-owned enterprises

face unique challenges that stem from their collective nature. One of the factors that led to the development of a network during this past year was the recent NGC Pilot Project funded by Agriculture and Agri-Food Canada's Canadian Adaptation for Rural Development Program.

A final comment needs to be made about the affect of the Canadian Wheat Board (CWB) on NGC development. A number of producers and observers have argued that the presence of the CWB is limiting NGC development. One reason they suggest is that the CWB's buy-back policy makes it impossible for the NGC to source grain from its members at a low price (such a strategy could create a competitive advantage for the NGC). The CWB's buy-back policy also creates problems with having members from the US as well as Canada. More generally, the view is that the presence of the CWB removes the incentive for individuals to undertake investment in new activities.

While it is true that the presence of the CWB in the grains industry does impose numerous constraints on the activities of an NGC wishing to operate in this sector, these constraints do not exist in other sectors such as cattle, hogs, and canola, and specialty crops (e.g., lentils, field peas, chick peas) and livestock (e.g., bison, ostrich, emu). Since NGC development does not seem to be any more prevalent in these sectors than in grains, the conclusion has to be that other, more generic, factors—such as the lack of development support—are behind the lack of NGC development in Canada.

The Adaptation and Evolution of NGCs

Co-operatives, like all other organizations, evolve and adapt over time. The key to evolution and adaptation is innovation, which is almost always the outcome of an attempt to solve a problem of one sort or another. Since the nature of the problem depends on both the larger environment and the individual human actors involved, the problems are always unique. As a result, innovation in co-operatives is varied, local, and grounded in the context of the particular experience of the co-op, its members, and the person undertaking the adaptation. Many people try many things, but the innovations that spread (both within and among organizations) are

the ones that work. People can choose to promote innovation, but in the long run it is the environment that decides which innovations will succeed.

Unsuccessful adaptations and innovations tend to be forgotten, although they are sometimes remembered and resurrected at a later date when circumstances change. Successful adaptations, however, form the basis for additional innovations elsewhere as people copy or import the new adaptation, which always involves some modification since the individuals making use of the idea never face the same set of circumstances that confronted the original innovator.

A good example of this process can be found among NGCs. NGCs first emerged with the formation of American Crystal and were then copied by other farmers in the sugar-beet industry. As the NGC model showed itself to be successful, it was adopted in other sectors and in other geographical locations (e.g., Dakota Growers Pasta, North American Bison) by farmers facing their own set of problems. Each time, however, the structure was modified somewhat to fit the distinct needs of farmers in a particular area or a particular sector. US Premium Beef, for instance, was formed for very different reasons than was Spring Wheat Bakers. Although both co-ops were formed to add value to their members' farming operations, US Premium Beef was created to increase incomes by enhancing the quality of beef moving to the retail market, while Spring Wheat Bakers was formed to increase incomes by exploiting a growing segment of retail demand that was not yet full of large competitors. In turn, the structure of these two organizations is also quite different.

Not only were subsequent NGCs formed for different reasons, they were formed via different mechanisms. Spring Wheat Bakers, for example, adopted an approach completely different from most NGCs, asking members for money to conduct an extensive study of market possibilities, rather than for money to examine the feasibility of one or two options. Further alterations to the NGC model are also evident. In Kansas, for instance, the 21st Century Producers Alliance group has members invest in a fund that actively seeks out numerous investment opportunities in a wide variety of sectors before choosing one to develop. Thus, the NGC model is not monolithic and unchanging. Instead, it has been adapted and modified to meet

the needs of the farmers in a particular location or a particular market segment.

Although the NGC model can and should be expected to adapt and evolve, there are some aspects of the model that are critical to its success. First, the capital investment by NGC members is important. While a large capital investment requirement may make it difficult for some farmers to become members, the lack of such an investment makes the co-op vulnerable to the ups and downs that invariably occur in processed product markets. As with any business, a low debt-to-equity ratio is vital for continued operation. In addition, a small capital investment per member appears to be correlated with reduced member commitment.

Member commitment is also influenced by the nature of delivery rights. A number of NGCs in the US have experimented with letting members purchase product on the open market (and then deliver it to the co-op) rather than produce it themselves. Although a complete analysis has not been undertaken, preliminary evidence suggests that member commitment problems emerge when this practice becomes widespread within the co-op. A number of NGCs are now looking at this issue as part of their strategic direction.

As mentioned above, NGCs are often formed where relationship risk and asset specificity are issues. NGCs are well suited to deal with asset specificity, but only if they maintain strong delivery rights. Asset specificity can be expected to become more and more important as agriculture transforms itself. During this transformation, agriculture will become more capital intensive, and the increasing production of specialized products implies that farmers' assets, too, will become more specialized. Because of these factors, NGCs will need to ensure that the delivery right characteristic is maintained.

Governance and control issues are also important. Like any co-operative, NGCs need to ensure that members maintain a strong sense of ownership and control, since this is a key factor in member commitment. As a result, the NGC governance structure must promote these elements. For instance, an NGC that engages in multiple activities and has adopted a highly complicated organizational structure is likely to have greater prob-

lems with member commitment than one that keeps a focus on a small set of activities and maintains a relatively simple organizational structure.

The argument about ownership and control also extends to investments. A few NGCs have experimented with having substantial investment by outside parties. The concern with this practice is that the members of the co-op may at some point lose their sense of ownership in the NGC and their commitment may wane. The more common strategy for accessing capital is for the NGC to form a joint venture with the other investment partners. This model has been followed, for instance, in the Manitoba egg co-op (they have formed a joint venture—Trilogy—with Michael Foods and Innovotech), and by US Premium Beef. This strategy allows the members of the NGC to retain a greater sense of ownership and control.

Challenges for NGCs

NGCs are currently facing a number of challenges. The first concerns intergenerational transfer. A number of the NGCs in the US—particularly those in the sugar-beet industry—are at a point in their history where many of the original members wish to leave the co-op and take their equity with them. These members, of course, would like to see the maximum value for their delivery shares. The incoming members, however, view high delivery share prices as highly problematic for their own farming operations. Not only do high share prices require the layout of extra capital—capital that could be used on the farm—but they also have a greater risk of collapse, thus exposing the incoming members to considerable risk. The intergenerational transfer issue, it should be noted, is even arising in some of the more recently formed NGCs. Dakota Growers Pasta, for instance, formed roughly ten years ago, is considering expansion into Canada in part because it is looking for a group of farmers who are willing to invest in the NGC, thus allowing some of the older members an opportunity to retire. Considerable experimentation and research is required to address this issue.

A number of NGCs are increasingly experiencing problems with member commitment, something that was not the case a few years ago. As mentioned above, some of this fall in member commitment can be linked to

the lack of an obligation to produce the product that is sold to the NGC. As a consequence, some NGCs are looking at their policy in this area. A number of other factors are likely at work, however, including the nature of the governance structure used in the co-op, the degree to which the NGC has stuck with a core business, the degree to which the co-op has been able to provide demonstrable benefits to its members, and the degree of homogeneity in the membership. Once again, considerable work is required to address this issue.

Some NGCs are finding that they need to be connected to other NGCs in order to provide common goods or services at the lowest possible cost. Leaders in these organizations are openly discussing the idea of something akin to a federation or network of NGCs and other co-ops. NGCs within this network/federation would remain autonomous. Key goods or services, however, would be provided jointly, with individual NGCs having the option of sourcing their goods or services from the network/federation. The discussion also includes a similar vision for the traditional co-ops—the view is that the large centralized co-ops need to break up their organization and create largely autonomous co-ops over which members would have a greater sense of ownership and control. These autonomous co-ops could also be included in the network/federation.

A final challenge is one of how producers can better position themselves within the new agriculture discussed at the beginning of the paper. To operate effectively in this agriculture, farmers need to develop a different relationship with agricultural technology than they have had to date. Farmers need to find a mechanism whereby they can control some of the intellectual property rights associated with new technologies, particularly where these new technologies are closely linked to differentiated and more highly processed products.

Farmers have been taking some steps in this direction over the last ten years. R&D expenditures by producer groups—usually funded through output check-offs—have been increasing (good examples of this trend include the canola and pulse industries). Most of this R&D expenditure, however, has been focussed at the farm level—e.g., new varieties and new production practices. Part of the reluctance to invest in greater processing

has to do with the cost and riskiness of this R&D activity. Regardless of the reasons, farmers themselves need to undertake more R&D activity in further processing.

To be able to effectively position farmers for the future, government also needs to consider a change in its funding of agricultural R&D. While government should continue to fund and support R&D into farm-level aspects of generic agricultural products and then provide the results of this R&D freely to farmers, it should do at least two other things:

- Government should begin to invest in R&D that is more processing and value-added oriented; and
- Government should develop mechanisms whereby farmers can be given ownership over the intellectual property that results from this R&D.

The government could make this investment—perhaps in partnership with producer groups—and then turn the intellectual property that is developed over to groups of farmers for a minimal charge. The groups to which this property would be transferred (or at least a portion of them) would have to be representative of farmers and would have to demonstrate that they have the ability to effectively manage the property. The commodity groups (e.g., the Canola Commission) that currently fund R&D would be obvious candidates for the turnover of intellectual property. Other candidates would be groups of farmers organized into co-operatives, particularly NGCs, since an NGC would be able to control production of the product. As with the other items discussed in this section, this idea requires a great deal of further thought and development.

Conclusion

NGCs have emerged as a response to the transformation of agriculture that has been occurring over the last ten to fifteen years. Like their predecessor co-operatives that formed during the early and mid-twentieth century, NGCs are playing an important role in keeping the agricultural sector and rural areas healthy, prosperous, and efficient.

While the transformation of agriculture has clearly been a necessary

condition for NGC development, this factor alone cannot explain it. To date, NGC development has followed a very different pattern in the US than in Canada. NGCs have developed in the US in large part because of the significant amount of assistance they have been given, whether this be in the form of development officers who work closely with producer groups, funding for business plans, or access to credit. This type of assistance has not been present in Canada and is likely the single largest factor in explaining the lack of NGC development in this country.

NGCs can play an important part in Canadian agriculture. Much is known about them, how they work, and what is needed for their successful development. Unless some deliberate effort is made to develop them, however, their potential will remain unrealized. While additional research is required, this research is not about the basics. The basics are known and they can and should be developed and built upon.