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New Generation Co-operatives

Responding to Changes in Agriculture

BRENDA STEFANSON
MURRAY FULTON

September 1997

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UNIVERSITY OF
SASKATCHEWAN

Centre for the Study
of Co-operatives

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Introduction

PRAIRIE AGRICULTURE is facing many changes, including the loss of the WGTA, the move to vertical integration and contract farming, and the changes to supply management and marketing boards. The changes to long-standing institutions create a new framework within which farm managers must make decisions. The move to vertical integration and contract farming affect the control farmers have over production and marketing decisions, while deregulation creates uncertainty and shifts risk onto the farmer.

Farm managers require new information to enable them to operate effectively in this new environment. Farmers now need to understand chain management and how to position their farm operation in the distribution chain to minimize the negative impact and maximize their opportunities. The emphasis on adding value encourages farmers to reach for profit centres in areas in addition to raw agricultural commodities.

This booklet, materials package, and video entitled *New Generation Co-operatives: Opportunities in Agricultural Processing* are designed to present the new generation co-operative model as a form of producer ownership of processing ventures. The model enables farmers to pool resources and share risks to solve problems or create opportunities. By vertically integrating forward in the distribution chain, farmers can maintain control over their operations, reduce risk, stabilize income, and secure markets.

In Minnesota, the new generation co-operative concept has been in place since 1974. At that time, sugar beet growers were losing the market for their product because the company processing sugar beets was moving out of the state. In response, sugar beet growers formed a co-operative, American Crystal Sugar (ACS), and purchased the processing plant. Since that time, ACS has been operating successfully, using the features we now associate with the new generation co-operative. Sugar beet

growers recognized the benefits of this structure and replicated it across the state. Involvement in the sugar beet co-operatives continues to encourage local farmers to use this structure to add value to the products they once sold as raw materials. Stories of the success of these ventures have travelled beyond the area of sugar beet production and spilled into a wide range of commodities. It is not uncommon for a farmer to be a member and director in four or five producer co-operatives and active in the development process of one or two more.

Conversations with these co-operatively active farmers reveal a different mind-set and an optimistic attitude. To these farmers, the co-operative processing operation is an extension of the farm operation. They are able to retain ownership of their farm product as it proceeds along the food chain. In doing so, they are able to access the returns from the processing and marketing of the food product that results from the processing of their raw commodity. They recognize two profit centres: the raw commodity and the processed product. They are able to make decisions and exercise control at both the production and the processing level. They have learned that collective action utilizing an effective and efficient business structure can solve problems and create opportunity.

The Transformation of Western Canadian Agriculture

WESTERN CANADIAN AGRICULTURE is in the process of a major transformation. Some of the forces behind this transformation are global in nature, while others are specific to the region.

At the global level, agriculture is undergoing a process of industrialization. The industrialization of agriculture has been defined as “the application of modern industrial manufacturing, production, procurement, distribution, and co-ordination concepts to the food and industrial product chain” (Boehlje). Key elements of this transformation are that markets are less commodity driven and more product driven; pro-

duction is more capital intensive; decisions made by firms at all levels of the market are increasingly interdependent; price and production risks are replaced with risks surrounding relationships and food health and safety; and information becomes a prime source of control and power. These changes are resulting in increased vertical co-ordination and integration; in addition, firms are more and more frequently being asked to deliver products of consistent quality at the appropriate time (Boehlje, Drabenstott).

Another part of the global transformation is a major change in the role of government. Government is withdrawing from agriculture, whether it be in the removal of price-support programs and production-based subsidies, the deregulation of industries such as grain transportation, or the withdrawal from agricultural research. There is also a loss of support for marketing boards and government marketing agencies. The view that agriculture deserves special treatment no longer holds sway.

Some of the forces behind the transformation of agriculture in western Canada are unique to this region. Included in these regional forces are the removal of the Western Grain Transportation Act (WGTA) and the challenges to the Canadian Wheat Board (CWB). The removal of the WGTA has not only reduced the price of grain in western Canada, but it has resulted in the replacement of a highly regulated system with what many anticipate will be a market-based system. Although the CWB still retains single-desk selling authority in wheat and barley for export and for human consumption, firms are taking steps to position themselves for the possibility that the CWB will lose this authority in the next five to ten years.

The Implications for Farmers

THE TRANSFORMATION DESCRIBED ABOVE has significant ramifications for farmers. The most immediate impact of the WGTA removal and the loss of government support programs is an expectation of less income from grain and oilseed production. Although the development of new value-added processing opportunities on the Prairies (e.g., canola-crushing plants and hog

production) will provide some economic activity in rural Saskatchewan, these activities will not enhance the price of grain at the farm gate, which will continue to be set by the world price, less transportation costs. At the same time, the loss of government support means that farmers will have to deal with the full impact of future downturns in agricultural commodity prices.

The changing structure of agriculture also has implications. In traditional agriculture, farm production was a distinct stage in the product chain and farmers could concentrate on it exclusively. The movement towards specialized production and much greater integration with input suppliers or processors means farmers can no longer view themselves as independent. The emergence of niche markets, for instance, not only creates a need for specialized inputs, both by processors and by farmers, but it also demands that decisions at the farm input level, farm production level, and processing level be co-ordinated to achieve economies of scale. As long as these activities remain independent, all players fail to achieve an optimal scale. The result is that farmers can expect increasing levels of contracting and vertical integration.

The emergence of greater contracting and vertical integration, however, raises questions about control and power. Farmers can expect increasingly to give up control over farm-level production decisions. Because of the information agribusiness firms possess about product quality and its importance, these firms are likely to have the power to set contract terms. With greater contracting, farmers also face new risks, such as the possibility that a processor, for instance, will change the contract terms once farm production has occurred. This risk increases as the assets needed for agricultural production become more and more specific to a particular product.

Co-operative Strategies in Response

THE CHANGES AND RAMIFICATIONS outlined above suggest that farmers need to become more involved in the provision of agricultural inputs and the processing of agricultural products than they have been to date. Lower prices for grain and oilseed

products, for instance, mean that farmers that continue to be involved only in farm-level production will find themselves being increasingly subject to control from input suppliers or agricultural processors.

It is difficult for farmers to involve themselves in the provision of agricultural inputs and the processing of agricultural products. Only the most prosperous have the financial ability to invest in processing or input activities, and even then only at a fairly modest level. Large-scale involvement in these activities takes much more capital, time, and expertise than is available to any single farmer.

One way for farmers to become involved in processing or input activities is through some sort of joint activity. The New Generation Co-operatives (NGCs) that have formed in North Dakota and Minnesota are a good example of farmers getting together to do something they could not do individually. Curt Watson, president of the hog production co-operative, ValAdCo, in Renville, Minnesota, puts it very well when he says that the reason he became involved in ValAdCo is that it was only by joining together with his neighbours that he was able to own a large-scale processing operation.

Although farmer involvement in processing can take many forms, the formation of co-operatives must be given special attention. 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.

New co-operative structures are required to meet the challenges of the new agriculture. The NGCs formed in North Dakota and Minnesota provide an excellent model. NGCs are producer-owned, restricted-membership co-operatives formed to process the agricultural products of their members. Examples of co-ops that have recently formed include a bison processing co-op, a pasta plant, an organic grain mill, a vegetable processing operation, sugar beet processing plants, and hog operations.

Capital requirements are met, to a large extent, by members purchasing delivery-right shares up-front. These shares provide members with a feeling of ownership, ensure low levels of debt in the co-op, and promote member commitment. The result is an increased potential for the long-term success of projects adopting this organizational structure.

Delivery contracts specify grade, quality, and production standards, enabling the co-operative and its members to access niche markets through identity preservation and quality control. Success in niche markets is dependent on assurances of quality as well as quantity. Consumers, increasingly concerned with health issues and food safety, are demanding chemical- and hormone-free foodstuffs. The co-operative is able to assess consumer preference and pass that information back to the producer-members, who, with this market information, can adjust production practices to meet the requirements of the consumer.

The structure adopted by NGCs parallels many of the changes occurring in the larger agricultural industry. High equity levels are required for the capital-intensive activities in which the NGCs are involved. Delivery contracts, often incorporating tight quality specifications, achieve the co-ordination required to maximize system performance. Most importantly, however, producer ownership provides farmers with information of what is valued in the market and reduces relationship risk. By owning the processing plant, producers can ensure they have an outlet for their production and that they obtain the benefits of providing quality products in a timely manner.

For a more detailed description of the NGC structure, refer to the booklet *New Generation Co-operatives: Rebuilding Rural Economies* and the video *New Generation Co-operatives: Opportunities in Agricultural Processing*, which are enclosed in the NGC package funded by AIMS and also available from the Centre for the Study of Co-operatives.

Co-op Profiles

VALADCO
 RENVILLE, MINNESOTA
 CURT WATSON, CHAIRMAN

VALADCO IS A FARMER-OWNED COOPERATIVE organized and incorporated in 1991. The cooperative operates four hog-breeding farms in Renville County, where they produce genetically superior breeding stock for resale to hog producers. The primary purpose of ValAdCo is to add value to shareholders' corn. Profits are distributed as "value added" payments in proportion to the bushels of corn delivered by the member to the pool.

Renville County is in the heart of the corn, soybean, and sugar beet production area of southern Minnesota. The cost of transportation has influenced the competitive standing of farmers who raise crops on some of the most productive land in the country. The Mississippi River barge terminals and Twin Cities mills are a hundred miles away. Railways are an expensive and often unreliable alternative. These farmers pay close attention when there is talk of increasing the value of their corn and reducing the costs of transportation.

The members of the cooperative are producers who view the organization as an investment that adds value to their corn in two ways. The cooperative farms use some of their corn as livestock feed, but the main impact is in increasing the availability of breeding stock for area hog producers. By helping to keep hog production in Renville County more viable, a much higher percentage of the corn raised there is used locally.

ValAdCo has approximately one hundred members and twenty-two full-time employees.

• NEW GENERATION CO-OPERATIVES

MIDWEST INVESTORS, INC.
RENVILLE, MINNESOTA
DANA PERSSON, CEO

MIDWEST INVESTORS IS A MARKETING COOPERATIVE incorporated in March 1994. Membership is limited to agricultural producers, seven of whom form the board of directors that governs the company. Midwest Investors was organized to invest in the production of eggs and egg products as an opportunity to diversify a producer's investment portfolio in "value added" agricultural production. The cooperative anticipates that it will explore investments in other value added opportunities as well.

Golden Oval is the egg production and processing division of Midwest Investors. Construction of an in-line egg production and processing complex began in Renville in June 1994. Each of the sixteen two-storey barns has a capacity for 127,000 laying hens. The first flock was placed in the barns in November 1994, and less than two years later, in October 1996, the last barn was completed and filled, bringing the total number of hens to 2 million. The processing building, which began operations in September 1995, houses the equipment that breaks and separates the eggs. At full capacity, the operation will yield approximately 55 to 60 million pounds of egg products annually, which will be shipped to meet the terms of marketing agreements with two companies that will further process liquid eggs into products for the retail and food service industries. Projected sales for Golden Oval are approximately \$20 million.

Two equity offerings have resulted in 383 producer members investing more than \$8 million to help finance the project, which will cost a total of nearly \$22 million.

SOUTHERN MINNESOTA BEET SUGAR COOPERATIVE
RENVILLE, MINNESOTA
AL RITACCO, CEO

FOLLOWING AN ANNOUNCEMENT IN MARCH 1971 that there would no longer be a market for their sugar beets, members of

the Southern Minnesota Beet Growers Association formed the Southern Minnesota Beet Sugar Cooperative, with the goal of building their own factory. Construction of the processing facility got underway in March 1973, and sugar production began at the new plant in the fall of 1975.

The 1994 crop was the largest in the cooperative's history, with the 465 grower/owners harvesting 2.4 million tons of sugar beets from nearly 110,800 acres. Pre-harvest began August 30 and full harvest ran for more than two months, from October 3 through November 5. Processing started on September 3, running for 223 days and averaging 9,408 tons of sugar beets sliced per day.

There are 250 full-time employees, with about 100 more added during the peak season. The annual payroll (excluding producer payments) exceeds \$10 million.

In addition to processing pure beet sugar, SMBSC also produces beet pulp pellets and beet molasses. The pellets are used as a feed for dairy cattle, beef cattle, and sheep; much of the yield is exported. The molasses is used in the production of yeast, chemicals, and pharmaceuticals, as well as a livestock feed. Beet molasses is further refined to produce additional sugar and the by-products betaine and separator molasses solubles.

NORTH AMERICAN BISON COOPERATIVE
NEW ROCKFORD, NORTH DAKOTA
DENNIS SEXHUS, CHIEF OPERATING OFFICER

IN NEW ROCKFORD, NORTH DAKOTA, 180 bison producers formed the North American Bison Cooperative (NABC), which started operations in 1993 and gradually expanded to its full capacity of ten thousand head per year. NABC buys and processes the bison produced by members, and markets the fresh and specialty meats into Europe and the upscale restaurant trade on the east coast of the USA. Currently, NABC is the only USDA and European Union approved bison processing facility in the United States.

The problems facing bison producers previous to this move included the need for product and market development, a lack of processing

facilities and marketing channels, and the absence of grading standards. The cooperative has dealt with these difficulties, providing co-ordination to the industry and developing strict grading standards. Member-owner investment in the organization has provided funds for research and development in production, processing, products, and markets.

Health conscience diners are increasingly demanding bison, which is said to be low in fat and cholesterol and therefore healthier than beef. The strict grading standards and careful attention to production practices enable NABC to provide consumers with a high quality, healthy product. In June 1997, NABC's board of directors, recognizing that demand will soon surpass the capacity of the New Rockford plant, announced plans to build a satellite facility.

Current membership in NABC, which covers fourteen states and four Canadian provinces, is 250, 60 of whom are Canadian producers.

DAKOTA GROWERS PASTA COMPANY
CARRINGTON, NORTH DAKOTA

IN NOVEMBER 1993, Dakota Growers Pasta Company began operation in Carrington, North Dakota. The cooperative has more than twelve hundred members from North Dakota, Minnesota, and Montana, and employs about 230 people. Dakota Growers annually produces about 100 million pounds of pasta in fifty different varieties. Marketed under the label Dakota Growers Pasta, the product is packaged for private labels, food service, and ingredient markets. In 1996, Dakota Growers began a \$5-million expansion to double the processing capacity of the Carrington plant.

After only two years of operation, the cooperative generated sufficient profit to enable a dividend payment to members, who received \$0.31US per share (i.e., per bushel of durum delivered), which represents a 20 percent return on investment. The grower-owners of Dakota Growers Pasta Company receive the market price for their durum on delivery, and have access to a second profit centre by sharing the returns to processing (Nadeau and Thompson).

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