New Generation Cooperatives on the Northern Plains

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The purpose of this site is to explore the development of New Generation Cooperatives on the Northern Great Plains. In particular, we examine the factors that led to a proliferation of these cooperatives in North Dakota and Minnesota in the 1990s. Several cooperatives are included as case studies. We also explore factors that might help New Generation Cooperatives succeed in Manitoba.

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We hope you find this site useful. The majority of the work contained herein is based on information gathered during 1999. Efforts have been made to ensure the contents of this site are as accurate as possible. Any comments, questions or concerns are welcomed. Please direct them to Michelle Bielik by e-mail

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Executive Summary: Overview of the Study

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I. Background

This is a study about the formation of a new generation of agricultural cooperatives in the United States. Most of this activity took place in the last decade of the twentieth century in the northern plains states of North Dakota and Minnesota. Several labels have been applied to these cooperatives including "new wave", "new age", and "new generation" cooperatives. The term "new generation cooperatives" seems to have won the day, and this is the term used in this study. For simplicity’s sake, the term “new generation cooperative” is abbreviated as NGC.

The purpose of this study is to examine developments in North Dakota and Minnesota regarding NGCs and to evaluate the potential for NGCs in Manitoba, given the American experience.

Considerable time has passed since 1995, when the Centre for the Study of Co-operatives at the University of Saskatchewan tried to raise the profile of NGCs and stimulate interest in Western Canada by showcasing the NGC developments that were taking place in North Dakota and Minnesota. In Manitoba, Saskatchewan, and other provinces there is now considerable interest in NGCs as a potential tool for business and rural development.

It is our hope and that of the Agri-Food Research & Development Initiative (ARDI) that this study will assist in the formation of new generation cooperatives and related business initiatives in Manitoba.

II. The Nature of NGCs

NGCs are a distinct type of cooperative. In turn, cooperatives themselves are a unique type of business organization. There are many forms of business organization in Canada and the United States such as the individual proprietorship, partnership, and several forms of corporation, of which cooperatives are one. Cooperatives are by no means restricted to agriculture. They are found in many different sectors of the economy, including credit and financial services, housing, utilities, health care, child care and insurance. It is estimated that there are about 40,000 cooperatives in the United States. As commercial business entities cooperatives are particularly prevalent in
agriculture. They range in size from entities such as Farmland Industries with revenue in the 10 billion ($US) range to smaller agriculture cooperatives that have only a few employees, including farming and machinery cooperatives.

The modern history of cooperatives is often traced back to the United Kingdom and the Rochdale Pioneers in the 1840s. The modern international cooperative movement is characterized by seven guiding principles. The seven international principles are:

- Voluntary and open membership
- Democratic member control
- Member economic participation
- Autonomy and independence
- Education, training and information
- Co-operation among co-operatives
- Concern for community

In the United States, cooperatives are generally characterized by three primary principles or characteristics. They are: user-owner, user-control, and user-benefits. In contrast, investor-owned-firms (IOF) are shareholder-owned, shareholder-controlled and benefits go to shareholders on the basis of investment.

The NGC is a cooperative in that it meets the three user-owned, user-controlled and user-benefit criteria. However, there is a subtle change in emphasis which moves the NGC more towards the IOF model. The emphasis on the member as the user remains; however, there is a significant increase in the emphasis on the member as an investor. The member in the NGC begins to take on many of the characteristics of the shareholder in an IOF.

The NGCs described in this study represent attempts by producers to move up the value chain and benefit from some processing or value added activity that occurs beyond the farm gate. In some cases this encompasses supply chain management right up to the consumer or retail level. The process, for example, begins with a decision by producers to build a processing plant for their commodity. Money is raised among the members to finance the plant. Debt and, in some cases, preferred non-member shares are also utilized. Total plant capacity is tied to the purchase by members of equity shares that obligate them to deliver a certain amount of the commodity to the cooperative. When capacity is fully subscribed the membership is closed. These delivery shares are a two-way contract between the producer-members and the cooperative. The shares are tradeable. If the cooperative is successful these delivery shares can appreciate in value. American Crystal Sugar Company and Dakota Growers Pasta Company are often mentioned as examples where such appreciation of shares has taken place.

The distinguishing features of NGCs might simply be summarized as closed membership and delivery shares:

1. Membership is “defined” or closed.
2. Delivery Shares
These delivery shares, in turn, have three distinct features:

a) Shares usually represent a high level of initial equity investment to which delivery rights are tied.  
b) Shares embody these delivery rights within contracts which define both rights and obligations of the producer and the cooperative.  
c) These shares are transferable or tradeable. They can appreciate or depreciate in value.

Since the early to mid-1990s, there have been a number of excellent articles published surrounding the theory and characteristics of NGCs. Included has been theory that outlines problems that develop as a cooperative matures, such as the free rider, horizon, portfolio, control, and influence problems. The literature explains how an NGC organizational structure can help to reduce these problems. Important theoretical trail-blazing was carried out at the University of Missouri by Michael Cook and his associates. As well, the Centre for the Study of Cooperatives at the University of Saskatchewan, under the guidance of Murray Fulton, has been an important participant in developing this understanding. However, these and other theorists were also observing the real world and trying to describe and explain a “co-op fever” that was already galloping ahead of academic understanding by capturing the minds, hearts, and pocketbooks of farmers in North Dakota and Minnesota. Key figures in this “co-op fever” were the cooperative leaders and champions who pioneered these initiatives. In addition to the farm leaders themselves, Bill Patrie and his associates with the North Dakota Economic Development Agency and subsequently the North Dakota Association of Rural Electric and Telephone Cooperatives were central to these efforts.

III. The U.S. Experience

It was said in the days of the Roman Empire that all roads lead to Rome. In terms of the “American Experience” all roads lead to North Dakota and Minnesota when it comes to new generation cooperatives. In an excellent USDA publication, *Creating Co-op Fever: A Rural Developer's Guide to Forming Cooperatives*, Bill Patrie outlines that “the models most often used to design new generation cooperatives come from American Crystal Sugar Company and Minnesota Corn Processors”. The ideas of up-front equity investment and producer agreements were ideas adopted from California experience and creatively adapted to the northern Great Plains situation.

The American Crystal Sugar model was attempted unsuccessfully a few times in the 1980s; however, it was not until the Dakota Growers Pasta Company’s success in the early 1990s that a model and a development process fully emerged. At this time, the stage was set and many other cooperatives were formed. This study focuses primarily on the North Dakota experience.

Although the North Dakota experience represents one model for stimulating economic development through NGC formation, preliminary research at the University of Missouri suggests at least four models. First, there is the North Dakota model which carries the hallmark of top-down efforts to stimulate, facilitate, finance, and organize NGCs. The words “top down” usually carry a negative connotation these days and this is often unfortunate. The central role and undisputed key to NGC development is the drive and involvement of producers and producer “champions”. However, these dreams were realized at least in part by the distinct, well planned, well executed, and enthusiastic role of public and private support for these efforts. Although Minnesota did not
have the same extent of “top down” support and focus of North Dakota in stimulating development, its experience has been similar. This is most likely because Minnesota shares a closely knit and interdependent farm economy with North Dakota, in which success in the sugar beet industry is common to the two states.

Other states have tried to duplicate the success of North Dakota and Minnesota. This second model has been termed the “emulation model” by the Missouri researchers. A third model might be called the “legislative” model. In states like Illinois, the lawmakers of the state have tried to stimulate NGC development by making legislation NGC friendly and by highlighting these legislative developments. A fourth model has emerged in Kansas. This might best be called the Kansas model to highlight the cooperative “21st Century Alliance” which is characterized by a formal venture capital approach. This approach first gathers potential farmer members/investors under a common umbrella and then proceeds to identify NGC-type opportunities for member consideration.

Other models that are unique or that are a blend of these four models will develop in other states and provinces. However, the basic framework and structure of NGCs developed and refined in North Dakota will be central to these developments. For this reason, much of the focus of this study is on North Dakota.

**Two questions comprise the focus of this study:**

- What were the factors and circumstances that led to the proliferation of NGCs in North Dakota in the 1990s?
- Can this experience be transferred to Manitoba?

### IV. The North Dakota Experience: Key Factors

There is always the temptation to search for single explanations for big events and developments. Several single factors have been put forward as the driving force in the North Dakota experience: cooperative roots, taxation, government vision, financial support, cooperative development support, and so on. Perhaps no one person has been closer to the overall North Dakota experience than Bill Patrie of the North Dakota Association of Rural Electric and Telephone Cooperatives. In reference to this new wave of cooperative formation, he suggests:

> “I do not profess to entirely understand why this phenomenon has resurfaced in the 1990s.”

Patrie goes on to say

> “The causes of ‘Co-op Fever’ are multiple, but the courage, intelligence and willingness of farmers in the Upper Plains to take a risk for reasonable returns is perhaps the single greatest reason for this phenomenon.”

This study agrees with the underlying sentiment that there is a complex set of several interdependent factors. These might be classified into three broad
This success, however, must be qualified. First, NGCs are not a “silver bullet” answer to increasing rural development and to decreasing the decline of prairie communities. Second, these successes have not been accomplished without their share of failure. In short, NGCs are not an automatic formula for success. They are, however, a positive addition to the available set of tools that can stimulate value-added activity on the Prairies.

A. Motivation

The adage that necessity is the mother of invention applies to the discussion at hand. Agriculture took a huge downturn in the 1980s in North Dakota and other states. In the eighties, North Dakota lost 15 percent of its family farms. Two professors from Rutgers University unwittingly motivated North Dakotans through their infamous “Buffalo Commons” essay in 1987. In this essay, the authors suggested that farm programs and other support to sparsely populated areas of the Great Plains was a net drain on the economy and that the United States would be better off to return much of this region to natural grassland. This created tremendous hostility toward the authors and the essay; however, it served as a catalyst in getting North Dakotans to think about the plight of North Dakota and to look for solutions. Interestingly, on October 19, 1999, Lawrence Solomon published a similar view about grain farming in Canada in the National Post, stating that “the farm economy now costs the country more on balance than it brings in”.

North Dakota’s overall situation was compounded by several factors, including the continuing industrialization of agriculture, vertical integration, globalization, changing farm programs and the declining farm value share of the food dollar. The message was clear: farmers would either be victims of these trends or they would have to begin to move beyond the farm gate to carve out a greater presence in the entire supply chain. Farmers could become entrenched as the suppliers of raw product to vertically integrated chains owned and dominated by large companies, or they themselves could vertically integrate upwards from the farm through mechanisms such as new generation cooperatives.

B. Capabilities

Important capabilities already existed in North Dakota, and these capabilities laid the foundation for the surge of NGC development in the 1990s. First, cooperative enterprise has typically been strong in North Dakota and Minnesota. Lee Egerstrom points out in his timely and important book, *Make no small plans: a cooperative revival for rural America* (1994), that much of the region was settled by Northern Europeans who were accustomed to cooperatives and cooperative approaches to enterprise, particularly in agriculture.

During the early formation of cooperatives in the grain belt in North America, cooperative approaches were largely defensive in nature. In economic terms, they were a reaction to market failure of one form or another. Most often they were a reaction to exploitative treatment of farmers by grain companies and railways. By the time the American Crystal Sugar Company was incorporated in 1973, however, cooperative efforts had a much more offensive tone. They were not taking action to provide a check and balance on existing investor-owned firms. In the case of American Crystal Sugar, they
were taking over an industry that would otherwise disappear, leaving beet growers without a market. In this regard, a second “capability” that we believe cannot be over-emphasized regarding the formation of NGCs in the 1990s was the early model of success provided by the sugar beet industry. As stated by Edmund Burke, “Example is the school of mankind and they will learn by no other.”

These developments in the sugar beet industry created a third set of capabilities that was critical to NGC formation: a group of trained, skilled, and motivated farm leaders who would go on to try to duplicate the model in other commodities. Most of these subsequent leaders or “champions” had been chairpersons or directors on the boards of the beet sugar cooperatives. These leaders understood the NGC model and they understood farmers. In addition, the leaders understood the mechanisms to stimulate public support for their efforts and, most importantly, they understood success when it came to moving up the value chain.

C. Policy and Programs

Several programs and organizations provided support for the increase in cooperative activity in the 1990s. In terms of these efforts, it is difficult to say which came first. An important effort in the late 1980s was Vision 2000 and the subsequent “Growing North Dakota” initiatives undertaken by the North Dakota government. The accompanying legislation in 1991 provided both focus and key support for value-added initiatives. In particular, the legislation provided a big boost to the funding capacity of the North Dakota Agricultural Products Utilization Commission (APUC) through the implementation of a Cooperative Marketing Grants program administered by APUC. Grants administered by APUC played an important role for NGCs. The first grant awarded from the Cooperative Marketing grant category went to the Dakota Growers Pasta Company. North Dakota’s legislative initiatives have continued with the “Enhancement to Growing North Dakota” program in 1997.

A second broad category of support for the formation of NGCs arose through the North Dakota Association of Rural Electric Cooperatives (NDAREC). In 1990, NDAREC began its Rural Economic Development Program, at which time it hired Bill Patrie as the director of the program. As well, NDAREC was instrumental in creating the Dakotas Cooperative Business Development Center in 1994. The Center is primarily funded by NDAREC and the Rural Business Cooperative Service of USDA. Through rural electric and telephone cooperatives, the Center provides loans, often at zero interest, to new or expanding rural businesses. The finances provided were important. However, the talent, enthusiasm and support for NGC formation provided by NDAREC through its economic development programs was an important factor in North Dakota’s success regarding NGCs. Bill Patrie and his team of development specialists were provided the funding to assist in cooperative development and were then given the freedom to pursue these goals. It is unlikely that this same role could be carried out by either government employees or private consultants.

A third broad category of support came from the banking and finance sector. Two institutions were important. Clearly the more important of the two was the St. Paul Bank for Cooperatives, which in 1999 merged with CoBank. The St. Paul Bank for Cooperatives acted as a business support system for cooperatives. It was involved in the start-up of many NGCs. Its leadership was very supportive of NGC activity, and its loan officers provided the
expertise needed to educate and guide potential start-ups regarding the challenges and requirements involved in forming a cooperative. A second important institution was the Bank of North Dakota, the only state-owned bank in the United States. It was aggressive in providing support for value-added processing ventures in North Dakota.

V. Lessons for Manitoba: Conclusions and Recommendations

Conclusions

There are several important conclusions to this study. Some of these conclusions are not new but they bear repeating.

1. New Generation Cooperatives are an important new development tool for rural economies. In future years, it will be shown that they were not an isolated phenomenon or oddity peculiar to North Dakota or Minnesota. The models developed in these states are spreading to other regions and countries, including Canada.

2. The NGC model is an outgrowth of the traditional agricultural business cooperative. Forces external to cooperatives (such as the industrialization of agriculture and globalization), and forces internal to cooperatives (free rider, horizon, control, portfolio, and influence problems) present significant challenges to the survival and success of traditional cooperatives. Traditional cooperatives are striving to meet these challenges in different ways. For new cooperatives, the NGC model deals with many of these same challenges.

3. One of the big challenges is the industrialization of agriculture. The NGC is often well suited to deal with this challenge. The advantages are perhaps greatest in single commodity niche markets where there is scarce investor-owned firm involvement or interest. The NGC provides producers with an opportunity to create a market for their product and participate in the supply chain for that product beyond the farm (e.g., bison, sugar beets).

4. A potential competitive advantage of the NGC over other firms is the tied integration of processing with the business of the farm. The farmer owner develops a greater knowledge of processing and of the demands of the consumer. This knowledge, when applied back at the farm level, results in improvements in product quality as well as farmer/processor relations.

5. There are several factors that explain the high level of interest in NGCs in North Dakota and Minnesota. First, the NGC may provide a market for the producer which would not otherwise exist (e.g., American Crystal Sugar Company). Second, the NGC may represent an attempt to increase local competition for the product and tighten the “basis”. Third, the NGC may simply be an investment vehicle for the farmer, allowing the farmer to participate in the investment of his commodity beyond the farm. The distinction between the farmer-as-owner and the farmer-as-venture capitalist in many cases may not be great. Finally, the NGC may be seen as a vehicle for rural development and community renewal.

6. The rural development motive is a two-edged sword. For the farmer/entrepreneur the compelling reason behind all investment decisions must be the business case. In the competitive world of agriculture, developing business solely for social reasons will likely fail. However, the rural development and community renewal motive is a powerful reason for both government and the public to participate. They do this by developing a vision
and direction for the province/state, and by facilitating development of new cooperatives through cooperative development support and start-up cost support.

7. In some cases, the NGC will be the most appropriate legal form of organization for the business. In other cases, different forms of partnership, corporation or traditional cooperative will be more appropriate.

8. The NGC is an important tool for rural development but it is not a "silver bullet". Sound business opportunities must exist and there will be failures.

9. It is important that legislation be accommodating to NGC formation. For example, legislation that requires costly and unnecessary steps regarding securities and disclosure can be a major disincentive to business development.

10. When choosing the legal form of the proposed enterprise, taxation may be an important factor. In the United States, cooperatives are accorded single tax treatment status for qualified profits allocated to members. In other words, the member pays taxes on these allocations while the cooperative can treat these allocations as eligible deductions. Similar status has evolved in the United States for certain types of private investor-owned firms, particularly the limited liability company.

11. The US experience regarding NGCs was driven by the coincidence of several factors. Many of these factors are common to both Manitoba and North Dakota, such as the regions’ strong cooperative heritage, poor commodity prices, enterprising crop and livestock producers, and the effects of industrialization and globalization. However, there were several key factors unique to North Dakota. If these factors can be ranked in importance, the first might be the existence of the sugar beet industry’s experience with the “American Crystal Sugar” model and its related impacts (success, knowledge, and experience). The second was the existence of cooperative development units that were allowed to operate with a high degree of freedom (in particular, the NDAREC’s cooperative development specialists). The third factor was the support and financial assistance provided by APUC, the St. Paul Bank for Cooperatives, the federal government, and the state-owned Bank of North Dakota. Manitoba’s success will be determined in part by our ability to develop similar approaches and competencies.

12. Although there are many critical success factors, three are highlighted. The most important is the soundness of the business opportunity. The NGC form of business is no substitute for good business sense. Second, timing of the fund raising can be critical. For example, Northern Plains Premium Beef seemed to be plagued by inopportune timing within the cattle sector. Many ventures in 1995/96 had opportune timing due to farm program payments and high grain prices. Third, timing of entry into the business can be critical. For example, the actions of Dakota Growers Pasta Company were advantageous in terms of industry timing.

As a closing comment, this study affirms the conclusion by many that there was a very exciting and distinct environment in North Dakota and Minnesota in the 1990s surrounding the formation of this new generation of cooperatives. This environment was highlighted by a quantum shift in entrepreneurial culture beyond the farm gate. It was nurtured by government and key organizations. It was aided by the sugar beet experience, high farm income in the mid-nineties, and several early success stories. It was implemented by farmers willing to
take risks with their time, their money, and their products. To quote Bill Patrie (in conversation): “What I like about New Generation Cooperatives is the direct involvement and commitment by producers with their dollars and their products.”

**Recommendations**

There are clearly some unique circumstances that propelled North Dakota to the forefront of NGC development. In particular, the state had potential NGC leaders and development assistance in place. These factors, when added to other more commonly found factors, ignited the spark for the North Dakota experience. This combination of factors explains, in large part, why North Dakota was the innovator and not Manitoba, Nebraska or other states or provinces. However, Manitoba has already taken several steps to encourage the development of NGCs. The following points underline these efforts and outline additional initiatives to encourage NGC development.

1. NGC friendly legislation

The *Cooperatives Act* (Chapter C223) has recently been updated and changed in Manitoba. Some of these changes to the Act will be more accommodating to NGC formation than previously.

2. A long-term strategy

A consistent, high profile, long-term strategy toward value-added processing and the formation of NGCs is needed. In North Dakota, a direction developed with the Vision 2000 process and was reinforced with the “Growing North Dakota” initiatives. A dedicated process in Manitoba with the goal of defining an understandable, visible, long-term strategy regarding value-added cooperative development is necessary.

3. Coordinated provincial public sector efforts

A number of provincial departments currently play a role in NGC initiatives. The department of Industry, Trade and Mines has responsibility for cooperative development. NGCs are primarily agricultural and therefore Manitoba Agriculture and Food is involved. Because NGCs provide an additional tool for rural and community development, Intergovernmental Affairs is involved. Other departments, including the Registrar of Cooperatives within Consumer and Corporate Affairs, are becoming interested and involved in NGC development. Other interested parties include the University of Manitoba, ARDI, Manitoba Rural Adaptation Council (MRAC), and the Manitoba Agricultural Credit Corporation. It is important that all of these efforts be centrally coordinated.

4. NGC start-up support

More support for the start-up of NGCs is needed. The early legal and consulting costs regarding formation, feasibility and funding are often modest in the broad scheme of things; however, it is precisely at this stage when funds are hardest to procure. In this area, the Manitoba Agricultural Credit Corporation is clearly a key player in the absence of institutions like the St. Paul Bank for Cooperatives and the Bank of North Dakota. The assistance provided in Manitoba by the Manitoba Rural Adaptation Council and provincial programs has been important in developments to date.

5. Manitoba Cooperative Business Development Centre
In North Dakota, the efforts of Bill Patrie and others through the North Dakota Association of Rural Electric and Telephone Cooperative's economic development programs were central to the formation of many NGCs. As part of the province's long-term strategy, a Centre should be developed in Manitoba to carry out these same functions. Such an approach requires that the Centre be funded and then given the independence to pursue NGC development without the constraints of government or the narrower focus of private consultants. Both the public and private sectors are important. However, such a Centre would complement these efforts while filling a void that neither can easily fill.
A New Generation of Cooperatives

A new generation of cooperatives has arisen in the northern states that border the Prairie Provinces of Canada. In the 1990s this development was an important new dynamic in the economic growth of the region. The pressures facing this region were not unique, yet this approach was unique. The concepts of cooperative enterprise utilized were not unique yet they were applied on a scale and in a manner not seen before.

In the 1990s, North Dakota and Minnesota experienced a new wave of cooperative activity. A 1994 article in one of Minnesota’s newspapers reported that at least $1 billion had been invested by farmers and rural citizens in new business investments, and listed 50 new generation cooperatives that were being formed primarily in North Dakota and Minnesota (Egerstrom, Saint Paul Pioneer Press). In 1999, the North Dakota Department of Agriculture reported that value-added cooperatives had built nearly $800 million in facilities since 1990, and that the state’s producers had invested $216 million in equity (North Dakota Department of Agriculture). New generation cooperatives are being used as a method for farmers to climb higher up the economic food chain. By further processing their raw commodities themselves, farmers are hoping to capture a greater share of the consumer food dollar. These new cooperatives are being formed as a way to diversify and stabilize producers’ incomes. In North Dakota, they are seen as a way to help keep rural families on farms and in small towns.

"The phrase rolling off North Dakotans' tongues these days is 'value added'. Much of the talk is about food processing--some call it 'moving farmers up the food chain.'" - excerpt from 1995 North Dakota State University Extension Service newsletter.

References
Features of new generation cooperatives

New generation cooperatives (NGCs) have several features that distinguish them from more traditional cooperatives found in the Northern Great Plains states. These features are:

- delivery rights that are tied to the level of equity invested
- closed membership
- higher level of initial equity investment
- transferability and the opportunity for appreciation or depreciation in the value of delivery rights.

Delivery rights

Equity shares in a NGC not only assign membership to producers, but they also allocate delivery rights and obligations. Producers purchase equity shares that obligate them to deliver a certain amount of farm product to the cooperative each year. For instance, one equity share may give the producer the right and obligation to deliver one bushel of a stipulated commodity to the cooperative every year. In the case of a NGC that processes livestock, the equity share may give the producer the right and obligation to deliver one animal to the cooperative every year. The delivery rights ensure that members provide up-front equity capital to the NGC that is proportional to their level of use of the cooperative. Any patronage refunds that the cooperative generates are distributed to members according to the level of product that they delivered to the NGC.

Essentially, delivery rights shares act as a two-way contract between the producer-members and the cooperative; they obligate the producer-members to deliver product each year to the cooperative, and in turn they obligate the cooperative to accept delivery of the product. The use of delivery rights assures producers a market for their product, and assures the cooperative a steady source of its primary input. Quality stipulations are specified; if the producer cannot fulfill his delivery commitments with his own product, then he must make arrangements to purchase the product from elsewhere to fulfill the delivery requirements. Otherwise, the cooperative will make arrangements to purchase the needed product from another source and charge the member for the difference.

The total quantity of delivery rights shares that the cooperative sells to producers depends on the processing capacity of the cooperative’s operations. The cooperative only sells enough shares so that it meets its efficient capacity level. For example, if the cooperative plans to operate a facility that has a capacity to process 3 million bushels of a commodity each year, then it will sell 3 million equity shares that each require the owner of the share to annually deliver one bushel of that commodity to the cooperative.

The price of each delivery right share is typically determined by dividing the total amount of equity capital that the cooperative requires to finance the business by the processing capacity of the cooperative’s facilities. Continuing with the above example, if the cooperative determines that it requires $12 million in equity capital, then the price per delivery right share will be found by dividing $12 million by 3 million bushels, which was the annual processing capacity of the facility. Thus, the price per
The shares that allocate delivery rights are separate from membership shares. Each individual producer holds only one membership share, but can hold more than one delivery rights share. Voting rights are attached to the membership share, and therefore each producer only has one vote in the cooperative’s affairs, regardless of how many delivery rights shares he may hold. This is consistent with the democratic principle of one member, one vote that characterizes most cooperatives. The cost of a membership share is typically a nominal amount.

**Closed Membership**

In contrast to many traditional cooperatives that typically accept new members on a continual basis, membership in new generation cooperatives is restricted once the targeted amount of delivery rights shares are sold. Once that occurs, new members will only be allowed if an existing member wishes to sell some of his delivery rights shares to another producer. This ensures a stable level of supply of product for the NGC; membership may change somewhat because producers wish to sell some of their delivery rights shares, but this does not change the supply of product being delivered to the cooperative. The sale of shares between producers typically requires approval from the board of directors before they occur.

**Higher Level of Initial Equity Investment**

Because of the presence of delivery rights, the initial equity investment required from producers is higher for a NGC than that found in most traditional cooperatives. NGCs typically raise between 30 and 50 percent of their total capital requirements from the sale of equity shares (Harris, Stefanson and Fulton 1996). Producers must pay for the right to deliver their commodities to the cooperative; in order to participate in the cooperative’s value-added processing, producers must provide up-front capital by purchasing delivery rights. The NGC usually sets a minimum required number of delivery rights shares that a producer must purchase in order to be eligible for membership. Because the members invest a significant amount of equity and are obligated to deliver product, they tend to remain more committed and involved in a NGC then they might be in a traditional cooperative.

In comparison to a more traditional cooperative, the NGC receives a higher level of equity financing at the start of its operations. The NGC is therefore in a position at the end of the year to return a greater portion of its patronage refunds in cash to its members, rather than retain them in the business as additional equity financing. In other words, since the members invest a significant amount of capital up front, most of the net earnings generated are returned to members at the end of the year rather than used as equity financing for the business. If the NGC decides to expand its operational capacity, then it issues more delivery rights shares, which provide the necessary equity financing for the expansion.

**Transferability and the Opportunity for Appreciation or Depreciation in the Value of Delivery Rights**

As mentioned, members of the cooperative are typically allowed to transfer their delivery rights shares to other members or other producers who wish to become members, subject to board approval. The price of the shares in these situations is negotiated between the member who is selling and the producer who is buying. The price of the shares will therefore fluctuate according to the performance and earning potential of the cooperative. If the cooperative is performing well and the buyer perceives strong earning potential from owning the delivery rights, then he may offer a price that is higher than that originally paid by the member. The member would
therefore be able to realize a gain from the appreciation of the share value. Alternatively, if the buyer perceives that the earning potential is weak, then the share might have decreased in value for the member.
The Northern Great Plains

The Northern U.S. Great Plains region is often defined as North Dakota, Minnesota, South Dakota, Nebraska, and Iowa. This area, which has sometimes been referred to as the breadbasket of North America, is the most farming-dependent region in the United States. Sixty-two percent of the non-metro counties in the Northern Great Plains states are farming-dependent, compared to only 24 percent of all non-metro counties nationwide. A county that is farming-dependent derives at least 20 percent of its labor and proprietor income from farming (Northern Great Plains Rural Development Commission).

The Northern Great Plains states share a history of farming and ranching that has evolved over the years. As the business of farming has changed, so has the rural infrastructure of these states: the number of farms has decreased, the size of farms has increased, and the rural population has declined. The United States Department of Agriculture (USDA) notes that 40 percent of counties found in Great Plains states have seen a continuous decline in population over the past 40 years (Rowley). The Great Plains has lagged behind other U.S. regions in population growth for over five decades, and many attribute this to the region's dependence on agriculture. One of the main reasons for the Great Plains outmigration has been a lack of job opportunities in the region, especially in farm-dependent counties (Rathge and Highman). As the farming population has declined, the demand for services in rural communities has also declined. As a result, many small towns that were formed years ago to serve the rural population have deteriorated, and many young adults leave to find better economic opportunities elsewhere. As for the farming population, many young people are not choosing agricultural production as a career because of a lack of perceived opportunities. The average farmer age has been increasing, and a greater proportion of agricultural production is now being done by farmers who are at or above a typical retirement age (Sonka). Cooperative development was one of the approaches used in North Dakota and Minnesota to try and stimulate rural economic activity.

The Northern Great Plains states have a strong history of cooperative activity. In the early 1900s, many farmers were beginning to feel that they were being taken advantage of by grain companies and railroads. They began to form cooperatives so that they could market their products themselves and increase their income. Many cooperatives were formed in the 1920s (Aksamit). Today, North Dakota and Minnesota rank among the four leading states having the highest number of agricultural cooperatives; along with Iowa and Texas, these four states accounted for almost 31 percent of the total number of farmer cooperatives in the U.S. in 1997 (Richardson).

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Agriculture and the North Dakota Economy

North Dakota’s major industry is agriculture; 38 percent of its economic base is attributed to the sector, and approximately 89 percent of the state is comprised of farmland (North Dakota Agricultural Statistics Service). It ranks among the top states in terms of its reliance on agriculture; in 1989, North Dakota ranked fourth in terms of the percentage of the gross state product that is derived from agriculture (gross state product is the gross market value of goods and services attributable to the state’s labor and property). Other nearby states are also highly dependent on agriculture. In terms of agriculture as a percentage of gross state product, South Dakota and Nebraska ranked first and second in the United States, respectively. Minnesota’s agricultural percentage of gross state product is also high relative to most states, although it was considerably less than that of North Dakota, due to the major influence of the Minneapolis/St. Paul metropolitan area (Coon, Leistritz, & Majchrowicz).
Similar with other regions, the number of farms in North Dakota has decreased over the years while the average farm size has increased. Technological advances in agriculture have increased the amount of land that one farmer can efficiently operate. In 1992, the number of North Dakota farms was 31,123, only about one-half the number that existed in 1954. Average farm size, on the other hand, increased from 676 acres in 1954 to 1,267 acres in 1992 (Coon & Leistritz). The average age of a North Dakota farmer has also increased; in 1997 the average age was 51, compared to an average age of 47 in 1982 (USDA Census of Agriculture). In spite of these changes, agriculture remains an important area of employment for North Dakota. In 1995, almost 24 percent of the state’s employment was in farm and farm-related jobs, in comparison to 15 percent for the U.S. as a whole (Economic Research Service Fact Sheets).

The state is the country’s leading producer of many crops, including durum wheat, barley, other spring wheat, sunflowers, and all dry edible beans. In terms of the percentage of its total state farm receipts, North Dakota’s two most important commodities are wheat and cattle, at 38 percent and 12 percent, respectively (Economic Research Service North Dakota Fact Sheet). With wheat playing such an important role, North Dakota’s agricultural economy is less diversified than most states (Economic Research Service, 1998). The state is a major exporter of wheat; in 1997, it ranked second among all states in terms of the highest value of wheat exported. With such a dependence on this particular commodity, however, North Dakota’s agricultural export base is narrow in relation to the other Northern Great Plains states (Northern Great Plains Rural Development Commission).
Because agriculture represents a significant portion of North Dakota's economic activity, the state is acutely affected by agriculture's performance. Due to external factors such as weather, price changes, farm policy, and foreign trade, the value of agricultural output can experience great variability from year-to-year (Coon, Leistritz and Majchrowicz). As a result, North Dakota's net farm income can experience great year-to-year volatility.

References
Factors leading to cooperative activity

“A convergence of circumstances, personalities, economic conditions, political culture and government actions created the phenomenon in the Northern Plains that has come to be known as ‘co-op fever’”. - William Patrie, Rural Development Director, North Dakota Association of Rural Electric and Telephone Cooperatives

Many factors, both economic and societal, have played a role in the emergence of new generation cooperative activity in the 1990s. Among the reasons put forth for new generation cooperative development in the region are:

- industrialization of agriculture
- the experience of the 1980s
- uncertainty regarding federal farm support and more liberalized trade
- cooperative spirit: “Buffalo Commons” and a strong cooperative heritage
- entrepreneurial attitude
- declining farm value share of the food dollar
- early models of success
Industrialization of Agriculture

The development of producer-owned processing cooperatives occurring in the U.S. has partly been a response to the larger transformations occurring within agricultural production and marketing. These transformations are often referred to as the industrialization of agriculture. Although definitions vary as to what industrialization of agriculture actually represents, one description provided by the Council on Food, Agricultural and Resource Economics is as follows:

“Industrialization in agriculture refers to the increasing consolidation of farms and to vertical coordination (contracting and integration) among the stages of the food and fiber system. The emerging system is expected to be highly competitive in global markets, more efficient, more responsive to consumer demands, less dependent on government assistance, and able to more rapidly adopt new technologies” (Council on Food, Agricultural and Resource Economics).

The Food and Agribusiness Sector

Adapted from S. Sonka, "Forces Driving Industrialization"

This diagram indicates the traditional depiction of the agricultural production unit (represented by the barn) and its relationship to the other sectors of the food and fiber system. The dark lines indicate that the production unit was traditionally seen as separate from other stages, including the input providers (depicted by the test tubes) and
the processing sector (depicted by the factory and loaf of bread). Industrialization of agriculture is effectively rubbing out the dark lines that separate the stages, so that production agriculture is now much more interrelated to the other stages of the system.

Industrialization of agriculture is focused on the consumer. It implies that changes in agriculture are occurring so that the industry can better meet the demands of consumers. Today’s consumers have a diverse set of tastes and preferences in the foods they choose, and they have come to expect a level of variety and excellence in the foods being offered in the marketplace. In order to meet consumer demands, the food supply chain is becoming more vertically integrated so that information about consumer preferences is driven back all the way to the initial producer. The steps in the production and marketing process are becoming more tightly linked so that products can be tailored to consumer specifications right from the very beginning.

Advances in technology allow information to be shared more efficiently. It also enables agricultural production to become more precise, so that products are can be fine-tuned to meet customer demands. These two technological benefits - the sharing of information and precision in agricultural production - allow products to be designed from the farm to the dinner table so that customer preferences are met. As a result, industrialization is helping to transform agriculture as a sector that was production-oriented to a system that is market-oriented. In such a system, farmers no longer produce and then look for a market in which to sell. Instead, those who control the supply chain ask, “what is it that the consumer wants” and then establish production systems or influence farmers accordingly. As the arrows in the following diagram indicate, in a market-oriented system the decision regarding what to produce begins with the consumer.

This transformation involves the realization that farmers are part of a larger food production system, and that the system produces according to the market demands of the consumer. Essentially, the food chain starts with what the consumer decides to eat, not what the producer decides to produce. A key question to be answered is: Are farmers simply a link in the chain that is largely managed by others, or can farmers play a
broader role in supply chain management?

The trend towards vertical coordination or integration has been occurring for some time; in 1996 the USDA reported that over the past 40 years farmers had become more dependent on production and marketing contracts and less dependent on spot pricing to market their goods. The trend was particularly prominent in the broiler, turkey, egg, and specialty crop markets; by the 1990's, contracting or vertical integration had become the dominant methods of producing and marketing these products (Economic Research Service, 1996).

Hog farming has also been affected by the trend; a 1999 USDA report noted that approximately 40 percent of hog sales to packers were coordinated by contracts and integrated operations in 1998, compared to only 3 percent in 1980 (Martinez). This trend accelerated in the 1990s with corporate concentration in all aspects of the pork chain becoming commonplace. As an example, in 1999 the largest hog producer and pork processor in the United States, Smithfield Foods Inc., announced its proposed acquisition of Murphy Family Farms, the country's second largest hog producer. With the completed acquisition, Smithfield would own about 12 percent of the hogs produced in the United States (Manitoba Co-operator, Western Producer).

**Traditional versus Value-Added Agriculture**

Some have suggested that industrialization has resulted in two types of agriculture: traditional and value-added. Traditional agriculture refers to the production of bulk commodities, in which large quantities of undifferentiated, broadly graded products are sold in anonymous spot markets. Price, quantity, and broad quality parameters are the key types of information needed. In traditional agriculture, the different steps of the production system can operate relatively independently from one another.

Value-added agriculture refers to the vertically coordinated production system that
designs agricultural production to meet the needs of a specific customer market. Specific product attributes is a key item of information. The focus is always on the final food product rather than the initial bulk commodity. In such a system, the production steps are interdependent. The shift towards value-added agricultural products is evident in the area of U.S. export growth. As a percentage of total agricultural exports, U.S. exports of bulk commodities have declined from nearly 75 percent in the mid-1970s to roughly 40 percent in 1996. Consumer foods, on the other hand, have risen from less than 5 percent of total exports to nearly 40 percent. More importantly, value-added exports have been found to generate more income and employment than exports of raw commodities. The Northern Great Plains region, however, is a major exporter of raw agricultural commodities (Northern Great Plains Rural Development Commission).

One of the primary differences between the two types of agriculture is expected to be profit margins; traditional agriculture and the production of bulk commodities will be characterized by low margins. Producing high volumes at the lowest possible cost is the key in such a market. Value-added agriculture, on the other hand, is expected to provide higher profit margins because it adds more value to the agricultural product (Drabenstott). A key question concerns who will control the vertically linked production system and benefit from these higher margins.

In a report released in 1988, the USDA wrote that "In the future, most commercial farmers will be part of a system - either a corporate one controlled by investors or a cooperative one controlled by producers" (Vogelsang et al.). In a sense, forming a cooperative is one way to help maintain producer independence; by agreeing to cooperate with each other and own their own business, producers can avoid becoming dependent on agribusinesses owned by investors who might have no personal involvement in the industry itself. Randall Torgerson, the deputy administrator of the USDA’s Rural Business - Cooperative Service department, has described cooperative businesses as “one of the few alternatives for farmers to coalesce as a means for individual survival” (Mach).

As well, by vertically integrating so that several steps of the system are controlled by the same group, producers can remove some of the conflicting interests or adversarial relationships that are typically found between producers and processors. For instance, dairy producers want a good price for their cream when selling to manufacturers who will process the cream into butter, but the manufacturer wants to give the producers a low price in order to obtain a wider spread between input costs and the price for butter (Morrison).
“Contract cooperatives...are a clear recognition that vertical integration is necessary but that it must be done from the bottom up or it will certainly be done from the top down.” - George Sinner, former North Dakota Governor

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The experience of the 1980s

The economic trends that North Dakota experienced in the 1980s have been regarded as one of the major reasons for the economic development efforts that were undertaken in the 1980s (Bangsund and Leistritz). Similar to many other agriculture-dependent regions, North Dakota went through a difficult time during the 1980s. As Bill Patrie, the North Dakota Association of Rural Electric Cooperatives’ rural development director and a key figure in the state’s cooperative development, described it: North Dakota “experienced some of the toughest years imaginable” between 1979 and 1990 (Campbell). According to Sarah Vogel, North Dakota’s Commissioner of Agriculture from 1989 to 1996, a sense of crisis emerged in the state as prices fell and production costs rose. To make matters worse, North Dakota experienced sustained drought for several years, one of the worst on record (Vogel, November 1996).

Federal farm program support became increasingly important to North Dakota producers. In 1986 and 1988, government program payments to producers actually exceeded the state’s total net farm income (Leistritz).
North Dakota's economy was extremely dependent on only a few industries, of which agriculture was the most important. During the period 1980 to 1990, agriculture, federal activities, and energy accounted for 44 percent, 26 percent, and 17 percent of the state's economic base, respectively (Bangsund and Leistritz).

North Dakota's farming community felt the effects of the agricultural downturn. From 1980 to 1990, North Dakota lost 15 percent of its family farms (Vogel, November 1996).

According to the U.S. Bureau of the Census, during 1980 to 1990 the population of North Dakota shifted from being predominantly rural to predominantly urban (Coon, Leistritz, & Majchrowicz). During that time, the state's total population dropped by almost 14,000 people (Coon and Leistritz). The breakdown between metro and non-metro population provides a clearer picture of the shift from rural life: from 1980 to 1990, North Dakota's non-metro population decreased by almost 37,000 while its metro population increased by 23,000 (Economic Research Service North Dakota Fact Sheet).

The effects of the farming crisis of the 1980s and the declining rural population led North Dakotans to look for ways to improve the state's economic situation. Many felt that big businesses from outside the region would not be interested in investing in new ventures within the state. North Dakota Senator Kent Conrad explained this sentiment: "Out-of state businesses have always looked at North Dakota in only two ways: One as a market for finished products made elsewhere, and two, as producers of raw materials for those products" (Nowling). Cooperatives were seen as a method to help generate revenues and, since they are locally owned, these revenues were more likely to remain in the region rather than flow to external investors situated elsewhere.
"I get angry when I think of how many millionaires North Dakota ranchers and farmers have created in other states by shipping their crops and livestock to others to add value to while we died poor out here on the prairie." - Ken "Doc" Throlson, President of North American Bison Cooperative

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Uncertainty regarding federal farm support and more liberalized trade

North Dakota producers were concerned about the effects that possible reductions in federal government support and more liberalized trade would have on the level of farm income and its volatility. U.S. farm programs focus on wheat and provide major income support to states like North Dakota. The prospect of a reduction in federal farm subsidies was of particular interest to the state’s farmers, as government payments represent a higher proportion of net farm income in North Dakota than in other states (Cobia). As a percentage of total farm income, government payments are higher in the Northern Great Plains than in any other region of the United States (Northern Great Plains Rural Development Commission). The USDA has reported that, in some areas of the Northern Great Plains, over 30 percent of gross farm income originates from direct government payments (Harrington and Dubman). In a 1990 report, the North Dakota 2000 Committee, a group formed to study North Dakota’s economic situation, noted that 40 percent of the state's net farm earnings were in the form of federal support payments (North Dakota 2000 Committee).

Producers were looking for alternatives that would help to reduce their reliance on government support. Cooperative value-added processing was seen as a self-help strategy that could contribute to this goal. Concern about the lessening of trade barriers and government support has continued throughout the 1990s.

In particular, the passage of the 1996 Federal Agricultural Improvement and Reform (FAIR) Act has led to concern about the stability of producer income from year to year. If government payments are no longer linked to market prices, then farmers may experience greater income volatility in response to changes in market supply and demand (Boland, Lusk and Barton). Producers are looking towards value-added processing activities as one method to stabilize income in such a market-driven farm economy. It is interesting to note that the high up-front payments that occurred under the FAIR act coincided with high grain prices. This may have boosted farmers’ ability to form cooperatives in the mid-1990s.

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Cooperative Spirit: ‘Buffalo Commons’ & a strong cooperative heritage

On an emotional level, a 1987 article written by two professors from Rutgers University, Deborah and Frank Popper, aggravated many North Dakotans and helped motivate them to look for ways to improve the state’s economic future. The essay suggested that the Great Plains, including North Dakota, was like a “buffalo commons” and that large areas of the state should be returned to natural grasslands, uprooting entire communities in the process. The professors argued that farm programs and other federal assistance to people in these sparsely populated areas were greater than the derived economic benefits, and it would therefore be more prudent to relocate people away from the Great Plains (Egerstrom).

Many ranchers, farmers, and communities felt the article was an assault on their livelihoods and legitimacy. The hostility towards the Poppers was so great that they needed armed guards at some of their speeches given in the Great Plains region (Popper). The reaction by North Dakotans to the article was one of outright indignation. However, it started many people thinking about the plight of North Dakota. North Dakotans wanted to prove that the state was economically viable, and cooperative development was seen as a possible method to improve the state’s outlook.

Cooperative enterprise has typically been strong in North Dakota and Minnesota. As part of a 1995 special section in the Fargo Forum concerning cooperative activity, one writer pointed out that "the seeds of the current boom in farmer-owned agriculture processing cooperatives were planted even before North Dakota became a state" (Gerboth). This has partly been attributed to the cultural heritage of the
region; many immigrants who settled in the area were Northern Europeans who were accustomed to cooperative ideas (Egerstrom). Northern Europe has a strong base of cooperative businesses; in Denmark, for instance, five cooperatives control about 80 percent of the market for processed food (Duffey). Some of America's largest cooperative businesses, including Land O' Lakes and Cenex Harvest States, originated in the Northern Great Plains region. When describing factors that contributed to North Dakota's cooperative activity in the 1990s, Sarah Vogel, the state's former commissioner of agriculture, pointed out that North Dakota had a strong base on which to build; many North Dakotans were already members of cooperatives and were therefore knowledgeable about the cooperative structure of business (Vogel, October 1996).

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Entrepreneurial attitude

In addition to a strong cooperative heritage, many producers in the region began to assume a more entrepreneurial attitude at the beginning of the 1990s. Lee Egerstrom, journalist and author of *Make no small plans: A cooperative revival for rural America*, described the transformation as follows: “Many farmers in these areas have acquired a new mind-set concerning how they fit into the food system. New generation cooperatives are an offensive tool. The farmer figures that if he has to live with volatile markets for his commodities, it could be in his interest to move closer to the consumer, to capture more of the consumer food dollar, by processing his own commodities” (Sjerven). The director of the Minnesota Department of Agriculture’s marketing division noted that many producers seemed to prefer the risk of making an investment in a value-added cooperative to the risk of waiting to see whether someone else would provide higher commodity prices (Groshen). Some producers might have felt that investing in a cooperative was a more attractive alternative to buying or renting more cropland, especially at a time when the costs of production were likely to be greater than the market price for the crop (Hegland). In contrast to preceding cooperatives, new generation cooperatives were seen as aggressive and proactive in nature.

Producers who were more likely to invest in value-added cooperatives have been identified by several studies. A report on value-added agriculture issued by the Northern Great Plains Rural Development Commission, a group established by U.S. Congress to study the economic development needs of the region, noted that “younger and more aggressive” farmers were likely to be investors in farmer-owned cooperatives. The report went on to say that this type of farmer was “more strongly oriented to consumer markets, and looks for new opportunities to create personal and local wealth” and that he understood “the changing agricultural landscape” (Northern Great Plains Rural Development Commission). A study conducted by North Dakota State University sought to compare the characteristics of farmers who became members of new generation cooperatives to those who did not. The results indicated that, on average, members were younger and tended to have higher levels of education and higher net worth than nonmembers. Members also displayed a stronger attitude than nonmembers that their role within the agricultural industry extended beyond the production stage and into the food processing and distributing stages (Olson).

Bill Patrie referred to the importance of the attitude of the region’s farmers in his USDA report entitled *Creating ‘Co-op Fever’: A rural developer’s guide to forming cooperatives*. When describing the reasons for the increased cooperative activity in North Dakota during the 1990s, he wrote: “The causes of ‘Co-op Fever’ are multiple, but the courage, intelligence, and willingness of farmers in the Upper Plains to take a risk for reasonable returns is perhaps the single greatest reason for this phenomenon” (Patrie).
Creating ‘Co-op Fever’
A Rural Developer’s Guide To Forming Cooperatives

by William Patrie
Declining farm value share of the food dollar

Food prices include payments for both the raw farm product and activities that occur once the product has moved past the farm gate, such as processing, transportation, wholesaling, and retailing. Thus, food prices comprise both farm prices paid to producers and charges for marketing services such as processing and distributing. For many years, farmers’ share of the consumer food dollar has been decreasing.

In 1998 the USDA reported that the farm-to-retail price spread, which represents the difference between the amount farmers receive for the goods they produce and the retail price consumers pay for food in foodstores, had been increasing every year for the past 30 years (United States Department of Agriculture). In 1997, the farm value (which represents the payment for the raw farm product) averaged 23 percent of the retail cost of a representative basket of U.S. foods sold in foodstores. The remaining 77 percent represented the farm-to-retail price spread, which consists of the processing, transportation, wholesaling, and retailing charges that add value to farm products after they leave the farm. In 1980, the farm value share of the consumer food dollar had been 37 percent, and in 1987 it was at 30 percent (Elitzak).

The farm value share has generally declined over time as rising farm productivity has created abundant food supplies that have held down farm prices. At the same time, rising food processing and distributing charges such as increased labor costs
have raised retail prices. Thus, retail prices have risen at a faster pace than farm prices. The result has been an increasing trend regarding the farm-to-retail price spread. Moreover, increases in these marketing input costs that occur past the farm gate, such as labor, packaging, and transportation, have a greater effect on retail prices than do fluctuations in farm prices that producers receive for their raw farm products. Retail prices have been known to rise even when farm prices have declined, reflecting an increase in marketing charges. The USDA has reported that the farm-to-retail price spread has increased at a greater annual rate than the farm value nearly every year for the past decade (Elitzak).

The farm-to-retail price spread examined above focuses on a market basket of retail grocery store foods. When examining the total expenditures for food at grocery stores, restaurants, and other food service institutions, the farm value share of the consumer food dollar is slightly lower; in 1997, approximately 21 percent of expenditures on domestically grown and consumed food represented the gross return paid to farmers. The remaining 79 percent covered charges for the marketing of foods that originated on U.S. farms. These marketing charges represent the difference between the farm value and the consumer expenditures made for food originating from U.S. farms.
In 1997, consumers spent $561 billion for food originated on U.S. farms. Of that amount, approximately $120 billion went to farmers. The remaining $441 billion represented the marketing bill for functions performed by the food industry - processing, wholesaling, transporting, and retailing. Labor represents the largest portion of food marketing costs; in 1997, labor represented almost half of the total marketing cost. Labor includes workers employed by food assemblers, manufacturers, wholesalers, retailers, and eating places. As the graph indicates, labor represented 38.5 cents of a dollar spent for food in 1997. In 1998 this amount increased to 39 cents while the farm value of a dollar spent for food decreased from 21 to 20 cents (Elitzak September 1999).
The amount of workers involved in food marketing has been increasing, with the majority of the growth occurring in employment at public eating places. This is consistent with the trend towards Americans eating more away from home meals; in 1997, the USDA reported that away from home meals and snacks accounted for 46 percent of the U.S. food dollar, compared to 38 percent in 1977 (United States Department of Agriculture). In 1997, spending for food purchased away from home increased more than spending for food purchased at grocery stores (Elitzak). The farm value share for food purchased away from home is less than that for food purchased at grocery stores, mainly due to the fact that one of the primary costs involved with food purchased away from home (such as in restaurants) is the labor involved in preparing and serving the food.

Consumer food expenditures have been increasing primarily because of increases in the cost of marketing food, rather than increases in the gross return paid to farmers. From 1987 to 1997, consumer expenditures for U.S. grown food increased by $185 billion. Of that amount, nearly 85 percent resulted from an increase in marketing costs. Rising marketing costs are also the primary reason for the increase in farm-to-retail price spreads; in 1997, the farm-to-retail price spread rose by an average of 4.7 percent while farmers received 4.4 percent less for the food they produced (United States Department of Agriculture).

While farmers’ share of the consumer food dollar has been shrinking, their costs of production have been rising. Thus, farmers have seen their net incomes pressured from both the revenue and expenditure sides (Hegland).

Cooperative investment in value-added processing has been used as a method to increase farmers’ share of the consumer food dollar. By maintaining control of their raw products past the farm and expanding their reach into activities such as processing and packaging, producers hope to obtain some of the marketing portion of the...
Some have also suggested that the relative profitability of food processors has been another primary reason for the increase in value-added cooperative processing activity (Boland, Lusk and Barton). Comparisons of return on equities between farmers and food companies show a large difference. Based on data from the USDA's Economic Research Service, the average return on equity between 1986 and 1991 for U.S. farmers was roughly 2 percent while the average return on stockholder equity for food manufacturers was roughly 17 percent.

Although agriculture represented a good portion of North Dakota's economy at the end of the 1980s, most of the activity took place on the farm with raw commodities, and processing took place outside of the state. Producers began to realize that potential profits existed in activities that occurred past the farm gate (North Dakota State University). As Jack Dalrymple, a state representative who was involved in several new generation start-ups, said, "It took us farmers 100 years to figure out the big grain and flour milling companies and sugar refiners were making all the money" (Alster).

"...we had a change in attitude. We faced the fact that we were a colony -- we exported raw commodities and imported processed goods. We realized farmers got too small a share of the food dollar" - Sarah Vogel, former North Dakota Commissioner of Agriculture

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Early models of success

The increase in cooperative activity in North Dakota and Minnesota is partly attributable to the fact that a handful of cooperatives formed in the early 1970s served as role models for later cooperative development. As well, people who were involved in the formation of these early cooperatives used their experience to help form other cooperatives later on (Cobia). Three sugarbeet cooperatives formed during the 1970s, American Crystal Sugar Company, Minn-Dak Farmers Cooperative, and Southern Minnesota Beet Sugar Cooperative, were early new generation cooperatives to form. Minnesota Corn Processors, a corn wet-milling cooperative formed in the early 1980s, has also been a role model for subsequent cooperative development (Sjerven).

American Crystal Sugar Company

American Crystal Sugar Company, with headquarters in Moorhead, Minnesota, is typically viewed as the “parent” new generation cooperative model in the Northern Great Plains region. The company originated in 1899 as a private corporation with factories located in California and Nebraska. It expanded its operations into Minnesota and North Dakota in 1926 and 1965, respectively. But after the industry went through a large expansion in the 1960s, American Crystal began to close several of its plants and neglect existing ones. With facilities shutting down, growers in the region saw the market for their sugarbeets threatened. In response, a group of beet growers who belonged to the Red River Valley Sugarbeet Growers Association offered to buy American Crystal in 1972. By owning their own company, the growers felt that they could maintain the market for their sugarbeets and improve the company’s operations. Over 1,300 beet growers paid $86 million for the company in 1973, transforming American Crystal from a publicly-traded, New York Stock Exchange listed company to a farmer-owned cooperative (American Crystal Sugar Company web site). Minn-Dak Farmers Cooperative and Southern Minnesota Beet Sugar Cooperative formed at roughly the same time. As a cooperative, American Crystal based its structure on a California cooperative model that called for producer delivery agreements and equity capital provided up-front by members (Patrie). Producers paid $100 for each share that gave them the right and obligation to sell sugar beets produced from one acre of land to the cooperative. By 1994, it was reported that American Crystal shares were selling at a price as high as $2,100 an acre (Egerstrom). Today, the three sugar cooperatives jointly own the largest beet sugar marketing company in the United States (American Crystal Sugar Company web site).

Although Minnesota Corn Processors was formed in 1980, new generation cooperative formation did not really occur on a significant level until 1991, with the establishment of Dakota Growers Pasta Company. Bill Patrie, the rural development
director for the North Dakota Association of Rural Electric and Telephone Cooperatives, attributes the lag in activity to the occurrence of several failures in between. In particular, several failed ethanol cooperatives and a failed potato processing cooperative made producers hesitant to provide capital to start-up businesses (Patrie).

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External Support for New Generation Cooperatives

Several programs and organizations have provided support for the increase in cooperative activity experienced on the Northern Great Plains in the 1990s. Together, these organizations have established a technical and financial infrastructure that has facilitated value-added agricultural cooperative formation:

- North Dakota Agricultural Products Utilization Commission (APUC)
- North Dakota Association of Rural Electric Cooperatives (NDAREC)
- Vision 2000 and the Growing North Dakota program
- Bank of North Dakota
- St. Paul Bank for Cooperatives
- Marketplace
- Commission on the Future of Agriculture (COFA)
- Quentin Burdick Center for Cooperatives

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North Dakota Agricultural Products Utilization Commission (APUC)

The Agricultural Products Utilization Commission (APUC) is often described as a key component in the state's support of cooperative development activities. It has been a very popular source of funding for feasibility studies and other start-up costs, such as legal and accounting services, for new generation cooperatives. This role, providing financial grants to a cooperative during its organizational stages, is a critical source of external support for cooperative development (Cobia).

APUC's mission is "to create new wealth and jobs through the development of new and expanded uses of North Dakota agricultural products" (APUC Biennial Reviews). Originally founded in 1979 to promote ethanol production, APUC's mandate evolved to include adding value to all of the state's agricultural products. It operates within the state's Department of Economic Development & Finance. Based on the Commission's success, several other states have requested information about the program (Hanson). Minnesota has a similar program, entitled Agricultural Utilization Research Institute (AURI). AURI was founded in 1987, and has also been noted for its support of cooperative development.

APUC provides North Dakota farmers, ranchers, and ag-related business owners with funding to pursue business development activities. In its Biennial Review, 1995-1997, APUC reported that since 1993, more than 160 projects had been funded. Funds are available through four main grant programs:

- Basic & Applied Research Grants
- Marketing & Utilization Grants
- Cooperative Marketing Grants
- Farm Diversification Grants

The largest portion of APUC funding goes to the Cooperative Marketing category (APUC Outcomes Assessment Committee). This grant category was added to APUC's program as part of the state's $21 million "Growing North Dakota" economic development legislative package that was initiated in 1991 (Vogel). Of particular importance to new generation cooperatives have been the Cooperative Marketing and Marketing & Utilization Grant categories. The Cooperative Marketing type of grant is awarded to groups or individuals working collaboratively on the production, processing, or marketing of agricultural products. The Marketing & Utilization type of grant is awarded to assist in the development of a marketing plan, including feasibility studies and business plan development. Cooperatives that have received support from APUC include Prairie Pasta Producers, Northern Plains Premium Beef, United Spring Wheat Processors, North American Bison Cooperative, and Dakota Growers.
Pasta Company. Some other cooperative projects that have been awarded grants include:

- Dakota Dairy Specialties, formed by dairy producers to process their milk into specialty cheeses
- Heart of the Valley Bean Cooperative, formed to market dehydrated bean products for its members
- Western Dakota Pork Cooperative, formed to add value to members' barley by feeding it to hogs

**APUC Funding Sources**

Funding for APUC comes from several government sources, both state and federal, including the state's Alcohol Motor Vehicle Fuel Tax Fund and a federal grant from the Rural Development Administration. In the period 1995 to 1997, APUC had $2,452,395 available for its grant programs, and in the period 1997 to 1999 the available grant funds amounted to $2,425,616 (APUC Biennial Reviews). The breakdown of APUC's funding for the 1997 to 1999 biennium was as follows:

- $1,014,243 Alcohol Motor Vehicle Fuel Tax Fund
- $1,750,000 Highway Tax Distribution Fund
- $1,083,219 General Fund Appropriation
- $500,000 Rural Business Enterprise Grant (received from the Rural Development Administration).

This amounted to $4,437,462, of which $2,452,616 was available for grants, $1,750,000 for the state's ethanol incentive program, and $171,846 for administrative expenses (APUC Biennial Review 1997-1999).

**Application Process**

Grant applications are accepted on a quarterly basis, at which time APUC's nine directors review the requests. Applicants meeting the eligibility criteria for board review are given 30 minutes at the quarterly meeting to present their proposal. The projects are judged according to an individual point scoring system. Funding decisions are generally made the day after proposals have been presented (APUC Biennial Review 1997-1999).

**Economic Impact**

In order to assess the impact that APUC programs had on the North Dakota economy, in 1996 the North Dakota State University's (NDSU) Department of Agricultural Economics analyzed 11 projects that had been funded under the Cooperative Marketing grant category. Included among these 11 projects were Dakota Growers Pasta Company and North American Bison Cooperative. The study found that total APUC funds of $867,381 granted to these 11 projects helped create businesses that directly added $84.5 million to North Dakota's annual economy. Secondary economic benefits amounted to an additional $160 million each year. Thus, APUC asserted that its direct annual return on investment for these 11 projects was $97 for each dollar spent, and its total return (including secondary benefits) was $297 for each dollar spent.

The 1996 study performed by NDSU concluded by saying, "the projects sponsored by the North Dakota Agricultural Products Utilization Commission are
adding value to the state's agricultural commodities and thereby creating new jobs, gross business volume, and tax revenues for the state economy. The economic contributions of these projects is substantial on a statewide basis, and even more impressive at the local level" (Leistritz).

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The North Dakota Association of Rural Electric Cooperatives

The North Dakota Association of Rural Electric Cooperatives (NDAREC), established in 1958, works with the state’s 19 distribution co-ops and 6 generation and transmission co-ops to provide quality service to the state’s population (NDAREC website). Its headquarters are located in Mandan, North Dakota. The NDAREC has formally been involved with cooperative development since 1990, and is regarded as a key supporter of new generation cooperative formation.

In the late 1980s, the NDAREC began to focus on the need for rural economic development. Its own well-being was at stake if no action was taken. A declining rural population would mean less demand for electricity, and the electric cooperatives would be left with excess, unused capacity. This trend was already evident. In the 1970s, the rural electric cooperatives expanded their capacity to serve the booming farm economy, which was thriving because of high grain prices. As well, energy projects in the state were booming due to high oil prices. Per capita income from 1970 to 1978 in North Dakota rose 142 percent. However, the boom faded by the early 1980s and the rural electric cooperatives found themselves with 1,000 megawatts of surplus power. Something needed to be done and the electric cooperatives, seeing that no one else was really stepping up to the plate, decide to initiate their own economic development efforts (Campbell).
In 1990, the NDAREC began its Rural Economic Development Program, at which time it hired Bill Patrie as the director of the Program (NDAREC Rural Development Program Report). Mr. Patrie remains as the director for the NDAREC’s rural development activities. Prior to joining the NDAREC, he had been an economic development officer for the state. Mr. Patrie has been involved with the formation of many new generation cooperatives. He also played a role in the development of the “Growing North Dakota” legislative package in 1991 and in the formation of the Commission on the Future of Agriculture’s report in 1998. Patrie, who was recognized as one of the ten most notable North Dakotans by the Bismarck Tribune in 1998, completed a manual for the United States Department of Agriculture (USDA) entitled Creating ‘Co-op Fever’: A Rural Developer’s Guide to Forming Cooperatives. This publication is based on his experience with agricultural value-added cooperatives.

Part of the NDAREC’s Rural Development Program is the Dakotas Cooperative Business Development Center, an organization that has provided strong support to new generation cooperative development. Mr. Patrie is the director of the Center.

**Dakotas Cooperative Business Development Center**

Established in 1994 and operating under the umbrella of the North Dakota Association of Rural Electric Cooperatives (NDAREC), the goal of the Dakotas Cooperative Business Development Center is to improve the quality of life in North Dakota by developing good paying jobs in rural areas. The Center provides technical assistance to develop value-added, cooperatively owned agricultural processing businesses. The Center’s technical assistance comes in the form of organizational development, strategic planning, start-up administrative services, fund raising for development activities, consultant referrals, due diligence on consultants’ reports, and assistance with obtaining financing. It also provides office space for projects that are in the development stage. The Center’s staff is comprised of a director, three cooperative development specialists, and an assistant. As well, some of the individual rural electric cooperatives have a cooperative developer on staff. This enables the Center to extend its reach throughout the state. Since 1994 the Center has been funded by a federal Rural Cooperative Development Grant provided by the USDA’s Rural Business Cooperative Services division, with matching funds primarily provided by the NDAREC. The Center also receives funding from the North Dakota Association of Telephone Cooperatives (NDAREC Pre-application for the Rural Development Cooperative Grant).

The Center performs other services that promote rural development. For instance, it implemented the Agricultural Research Fund for the State Board of
Agricultural Research, which funds research that seeks to improve the quality of agricultural commodities, increase efficiency in production, and make a positive impact on North Dakota farmers. The Center holds a position with the North Dakota Coordinating Council for Cooperatives, whose goals is to promote cooperatives and cooperative development throughout the state. The Center also has linkages with the Renewable Resources Research Institute, which is an organization that helps commercialize innovations in agricultural product use. It engages in outreach activities such as sponsoring conferences and participating in a national network of cooperative development centers. The Center’s staff are frequently asked to give presentations to other cooperative developers throughout the nation. The Center also holds an annual Rural Development Tour that allows participants to see first-hand the economic development occurring in the state. The last tour, held in July 1998, attracted 60 participants (NDAREC Pre-application for the Rural Development Cooperative Grant).

The Center also works with rural electric and telephone cooperatives to establish revolving loan funds provided through the USDA’s Rural Utilities Service. Rural electric and telephone cooperatives, with the Center’s assistance, apply for funds through Rural Utilities Service to establish these revolving loan funds. These funds are then loaned by the utility cooperatives to new or expanding rural businesses at an interest rate that is equal to prime or less. In some cases, zero interest loans are awarded (NDAREC Pre-application for the Rural Development Cooperative Grant). In the 1998 USDA manual, Creating ‘Co-op Fever’: A Rural Developers Guide to Forming Cooperatives, Bill Patrie indicated that zero interest loans were used aggressively by North Dakota cooperatives. Perhaps more importantly, the availability of these loans encouraged discussion among farmers about cooperative opportunities (Patrie).

**Individual Rural Electric and Telephone Cooperatives**

Individual rural electric cooperatives, along with rural telephone cooperatives, have taken an active role in projects undertaken within their area of service. They provide low-interest loans to help new projects and low-cost power in the early years of operation. In 1995, the Fargo Forum reported that these cooperatives had loaned over $4 million to 33 projects across the state (Springer). Three electric cooperatives that have been noted for taking an active involvement in projects are Basin Electric, Tri-County Electric, and Cass County Electric (Krause). Cass County Electric’s economic development specialist noted that the cooperative has helped several projects by hosting meetings to help get projects started, providing seed money, and
assisting in stock sales. It even provided a corporate airplane so that organizers of United Spring Wheat Processors could attend stock sale meetings in South Dakota and Minnesota (Koepplin).

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Vision 2000 and the Growing North Dakota Program

In the late 1980s key individuals and organizations in North Dakota began to formally evaluate the future direction of the state. In January 1988 a group entitled the North Dakota 2000 Committee was formed by the Greater North Dakota Association, a statewide chamber of commerce, to explore the state’s economy and examine its options for the future. SRI International Consultants was hired to assist the committee. Town hall meetings were held in 40 of the state’s communities to help North Dakotans explore the challenge before them and to begin thinking about their choices. Over 6,700 people attended these meetings. The program recognized that the state’s economy was at risk of declining further than it had already been. After nearly two years and thousands of hours of research, interviews, and meetings, the committee released its first report in 1990, entitled Vision 2000 Kick-Off Report. The report began with the following:

“Last October, the North Dakota 2000 Committee went out and asked if North Dakota was dying. The people of North Dakota said yes, it would, unless we change the way we look at things” (North Dakota 2000 Committee 1990).

The report cited the following facts to demonstrate the state’s fragility:

- North Dakota was the only state in the United States to have fewer residents in 1990 than it did in 1930.
- Per capita income had steadily declined since 1975 and was 15 percent below the national average in 1990.
- Young people were leaving the state. In the three years leading up to the report, 17,000 people between the ages of 22 to 25 had left North Dakota.

The Vision 2000 program recognized that North Dakota’s main income generators were agriculture and energy. It asserted that the state needed to specialize and focus its economy around four economic sectors:

1. Advanced agriculture and food processing
2. Energy by-product development
3. Export services and tourism

The report stressed the need to move away from producing basic products for traditional markets and move towards producing higher value-added products designed for new, more specialized markets. The Vision 2000 committee also noted that the state’s "single biggest obstacle" for moving forward was "people with negative mind sets" (North Dakota 2000 Committee, 1993).

Funded by a grant from several foundations, the state sent a delegation to participate in a planning session led by the Council of State Policy and Planning Agencies in 1990. The purpose of the session was to establish a structure for the state’s economic development process. The delegation was chaired by the state
governor’s chief of staff and included the executive vice president of the North Dakota Association of Rural Electric and Telephone Cooperatives (NDAREC), legislative and farm group leaders, and the president of the Bank of North Dakota. Bill Patrie, the state’s economic development director (and soon to be the director of the NDAREC’s rural development program) was also a participant. The delegation helped to devise a legislative strategy for economic development, and Bill Patrie contracted with the government to prepare a legislative draft. Governor Sinner then appointed a committee of 34 to implement a comprehensive economic development legislative program (Patrie).

In 1991 the state legislature passed a $21 million budget for economic development for the period 1991 to 1993. This amount was four times larger than any previous development budget (Department of Economic Development & Finance). The funds came from earnings of the state-owned Bank of North Dakota. This economic development legislative package was a set of policies and programs that was known as “Growing North Dakota” (Patrie).

Growing North Dakota

The program set five specific numeric goals for the state for the year 2000:

1. Have a state population of 700,000 people with equal population growth across all regions. In 1990, the population of North Dakota was 638,800, compared to 652,717 in 1980 (Coon and Leistritz).
2. Double the number of manufacturing jobs, from 16,400 to 32,800.
3. Maintain the current number of full-time farming operations.
4. Increase new exported service jobs by 8,000.
5. Have a per capita income equal to the national average.

In 1996, North Dakota Commissioner of Agriculture Sarah Vogel noted that a major overall theme of the Growing North Dakota initiative was to increase the farmers’ share of the food dollar (Vogel, October 1996).

The 1991 legislation did the following:

- Replaced the state Economic Development Commission into the Department of Economic Development & Finance
- Created Technology Transfer, Inc., a state-chartered corporation that provides funds for commercialization of new technology
- Created the North Dakota Future Fund, which provides equity and debt investment for primary sector businesses
- Implemented the Cooperative Marketing Grants category of funding available through APUC. The first grant to be awarded under this category from APUC went to the Dakota Growers Pasta Company (Vogel November 1996)
- Implemented the agriculture partnership in assisting community expansion
(AgPACE) fund, a program that helps to buy down the interest rate for on farm businesses and to foster non-traditional agriculture

- Provided funding for the partnership in assisting community expansion (PACE), a program through which the Bank of North Dakota participates with local communities to reduce interest rates on business loans for primary sector businesses
- Provided funding to the Agricultural Mediation Service, a program aimed at providing financial and managerial assistance to existing farmers so that they can remain in business
- Permitted an additional 5 years of property tax exemption for value-added agricultural processing facilities.

In 1993, the state legislature affirmed the Growing North Dakota program for a second time and appropriated approximately $18.5 million for the 1993-1995 biennium (North Dakota Legislative Council). In 1995, the Growing North Dakota program was affirmed for yet a third time.

**Enhancement to Growing North Dakota**

In 1997, Governor Schafer announced a program, entitled “Enhancement to Growing North Dakota”, to conduct more specific market analysis in order to identify North Dakota’s best opportunities for growth and diversification. The Department of Economic Development & Finance hired two consulting firms, Arthur Andersen LLP and Flour Daniel Consulting, to help with the project. These firms conducted a competitive assessment of the state. Enhancement to Growing North Dakota aims to create stronger linkages between government, education, and the private sector so that the state is better prepared to shape its economic future.

The Vision 2000 initiative has been credited with helping to create a more positive, entrepreneurial attitude in the state, and the Growing North Dakota legislative program has been key to the state’s technical and financial support of cooperative activity (Springer).

References
Bank of North Dakota

Bank of North Dakota (BND) is the only state-owned bank in the United States. It was formed in 1919 as part of the populist political movement in the state at that time, led by the Nonpartisan League. All state funds are deposited with BND. The bank’s mission has remained the same since its beginning: to encourage and promote agriculture, commerce, and industry in North Dakota. The bank was never intended to compete with or replace other banks; instead, BND cooperates with other banks in achieving its goals. In this regard, BND acts in partnership with over 100 other financial institutions in the state. With a few exceptions, such as student loans and farm real estate acquisition and refinancing, the bank is restricted by state law from lending directly to a borrower. Instead, the bank lends through participation with a lead financial institution. The bank acts as the state’s development bank. Over the past five years, BND, in partnership with private financial institutions, has helped over 1,000 businesses and industrial projects, putting over $800 million into North Dakota’s economy (Bank of North Dakota web site).

As its web site indicates, “financing economic development is the thrust of Bank of North Dakota efforts.”

BND has been recognized for its support of value-added processing ventures. Some of the bank’s programs that have played a role in this area are the following:

- **Partnership in Assisting Community Expansion (PACE).** Through this program, BND participates with a local lender in a community-based loan to a primary sector business, such as value-added processing, and buys down the interest rate on the loan. The rate to the borrower cannot fall below 1 percent. In 1996, it was reported that the PACE program had resulted in loans of $80.9 million to 209 businesses since the program began in 1990 (Vogel). The PACE program has helped provide attractive interest rates to value-added processing ventures.

- **Agriculture Partnership in Assisting Community Expansion (AgPACE).** This is an interest rate buy-down program that is intended to help diversify farming operations. The AgPACE program was implemented as part of the 1991 Growing North Dakota legislative package. The program is available to North Dakota residents whose principal occupation is farming. Proceeds can be used for the purchase of equity shares in a value-added processing facility. According to BND, the AgPACE program is “available to any business except traditional production agriculture, which is integrated into the farm operation and will supplement farm income” (BND Farm Loan Programs). For instance, bison ranchers used the AgPACE program to help with their purchase of bison herds that would eventually be delivered to North American Bison Cooperative. The program was so popular with bison producers, however, that bison was removed from BND’s category of nontraditional agriculture (Patrie).

- **Co-op Equity Loan Program.** This program was started in 1994 and provides funding to assist in the purchase of shares in agricultural processing plants. The borrower must be a North Dakota resident whose principal occupation is farming or ranching. The interest rate on BND’s portion of the loan floats at its base rate less 1 percent. The term of the loan is five to ten
years, and the principal payments may be deferred up to three years.

- **Value-Added Agriculture Equity Loan Program (ENVEST).** This program began in 1996 and also provides funding to assist in the purchase of shares in agricultural processing plants. Unlike the Co-op Equity Loan Program, however, the Envest program is not limited to a state resident whose principal occupation is farming or ranching. As well, the project's ownership does not necessarily have to be structured as a cooperative.

In August 1999, the ENVEST and Co-op Equity Loan Programs were combined into one and the AgPACE program was expanded (Humann).

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St. Paul Bank for Cooperatives

St. Paul Bank for Cooperatives is a customer-owned cooperative bank that provides a variety of loans and financial services to agricultural cooperatives and other eligible organizations, such as rural electric and telecommunications systems. The bank’s founder established that the role for St. Paul Bank was to “help build sound, well-managed, properly financed cooperative associations” (Johnson). It acts as a business support system for cooperatives. St. Paul Bank is part of the $84 billion U.S. Farm Credit System, a national network of farmer-owned financial institutions. The bank was one of thirteen Banks for Cooperatives created by the Farm Credit System in 1933 (CoBank). It has 600 customers in 26 states, although its primary service area is the Upper Midwest and Great Lakes states. Its main office is in St. Paul, Minnesota. The bank also has branch offices located in Fargo, North Dakota, and Mankato, Minnesota (Marketplace).

St. Paul Bank has been involved in the start-up of many new generation cooperatives, and its leadership has been noted as a major reason for the increased cooperative activity that took place in the 1990s. Its management has been helpful in educating potential start-ups about the challenges and requirements involved in forming a cooperative, speaking at various seminars and conferences, and writing articles for cooperative publications. The expertise of several of the bank’s loan officers has also been noted as a key reason for its popularity with new generation cooperatives (Patrie).

In 1999, the stockholders of St. Paul Bank for Cooperatives approved a plan to merge the bank with CoBank, another bank within the Farm Credit System. CoBank is a much larger operation. It was created in 1989 when eleven of the Farm Credit System’s thirteen Bank for Cooperatives consolidated into one operation. The twelfth Bank for Cooperatives consolidated with CoBank in 1995 (CoBank). Thus, St. Paul Bank for Cooperatives represents the last of the original Bank for Cooperatives to merge into CoBank.

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Marketplace

Originally designed to be a one-time event in 1989, Marketplace has become an annual showcase for ideas that promote rural economic diversification in North Dakota. Marketplace's organizing sponsors are U.S. Senator Kent Conrad and the state's Commissioner of Agriculture. The event is described by its organizers as "a supermarket of ideas, information, and resources for rural economic development" (Marketplace web site). Marketplace actively promotes cooperative development, including a 'Co-op Night' as part of the activities. The program involves two other primary features: an annual 'Marketplace Day' and a printed North Dakota Economic Development Resource Directory. Marketplace 2000 was scheduled to be held January 6, 2000 in Bismarck.

Marketplace Day involves "idea booths" set up by people who have developed their ideas into businesses, many of which are on-farm operations. The booths are set up so that these entrepreneurs can share their business experience with others attending the event. Workshops and seminars are also conducted. A wide range of speakers, including presenters from private businesses, government, universities, and farmers who are running their own businesses, conduct these sessions. Past presenters have included Ken Throlson, the president of North American Bison Cooperative (Vogel). Workshop topics include items such as business and farm management, food processing, and high value crops. In 1998, over 200 booths were set up and 100 workshops were held at Marketplace.

The Resource Directory is a printed booklet of over 100 pages that includes a list of economic development ideas and programs that are available to assist North Dakota's residents. Included in the Directory is a section on "How to Catch 'Co-op Fever'".

The first Marketplace held in 1989 was organized by Sarah Vogel, the state's Commissioner of Agriculture at the time, and U.S. Senator Kent Conrad. That first event attracted about 700 participants, and by the second year attendance had doubled. Since 1992 the event has attracted an average of 4,500 people each year. The event receives assistance from more than 200 businesses and other organizations. Major financial support is also received from the U.S. Department of Agriculture's Agricultural Marketing Service (Marketplace web site).

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Building the Future of North Dakota Agriculture

“The trusted provider of the highest quality food in the world!”

Commission on the Future of Agriculture
In the fall of 1997, North Dakota's Commissioner of Agriculture Roger Johnson announced plans to form a Commission on the Future of Agriculture (COFA) in North Dakota. He wanted the commission to address two main issues:

1. Assess North Dakota agriculture’s current situation and determine a vision for the future of the industry.
2. Develop recommendations that would enable North Dakota’s agriculture industry to achieve that vision.

The commission was formed partly in response to the harsh times that agriculture, the state’s main industry, had undergone in recent years. In particular, 1997 had been a rough year for the state’s wheat and beef cattle producers. According to the U.S. Department of Agriculture’s Economic Research Service, North Dakota’s net farm income in 1997 decreased by 90 percent from the prior year (Economic Research Service). During 1997, it was estimated that winter storms, spring flooding, early summer drought, and crop disease problems had led North Dakota farmers to endure losses of over one-half billion dollars; indirect losses were estimated to be nearly $2 billion (North Dakota Department of Agriculture).

COFA’s steering committee was headed by Johnson and included four other members from the North Dakota Farm Bureau and North Dakota Farmers Union (the state’s two largest farm organizations), the North Dakota Association of Rural Electric Cooperatives (NDAREC), and North Dakota State University (NDSU). The NDAREC was represented by its executive director, Dennis Hill. Mr. Hill had also served as co-chairperson for the program that led to the state’s Growing North Dakota economic development initiative in 1991. The steering committee established a 14 member working group, which included Bill Patrie and Jack Dalrymple, two men who had significant experience with new generation cooperatives. The commission itself was comprised of 61 members from various organizations, including commodity groups, farm organizations, private entities, the legislature, and state and federal agencies. Funding for the COFA was provided by the state’s attorney general, who gave the commission funds received from a $100,000 settlement of a lawsuit by the state against a chemical company. The steering committee hired Don Senechal of the consulting firm Senechal, Jorgenson, & Hale, to prepare an agenda and establish priorities for the commission. Senechal’s firm had been involved with the start-up of many new generation cooperatives in the state. His fee for the COFA project was $70,000 (Davis).

COFA held its first public forum in January 1998 at the state’s annual Marketplace event. Twenty other public meetings were later held throughout the state. More than 1,000 people attended these public forums, and others participated in writing. The public input process was similar to the approach taken years earlier in the Vision 2000/Growing North Dakota initiative, but now the process was focused on the state’s agriculture industry in particular, not just overall economic development. The working group went on to develop a draft report that was then modified and approved in June 1998 by the full commission. The commission’s work resulted in 54 recommendations.

COFA’s 15-page report, entitled Building the Future of North Dakota Agriculture, included the following vision and mission statements, and five main goals:

**Vision:**

“That North Dakota becomes the trusted provider of the highest-quality food in the world with:

- Prosperous family farms;
- Thriving rural communities; and
- World-class stewardship of resources.”
Mission:

“To significantly increase net farm income, improve the quality of rural life, and increase North Dakota’s rural population.”

Goals:

1. “Make North Dakota agricultural products synonymous with high quality, dominating the premium markets.
2. Increase value-added agricultural processing.
3. Diversify and increase the value of agricultural production.
4. Increase farm and non-farm cooperation that supports thriving rural communities and enhances our natural resources.
5. Create a political, regulatory, economic, trade, financial, and natural resource environment in which North Dakota producers can compete in the global marketplace.”

For each of the five goals, the report listed several objectives and recommended actions to take.

Value-added Agricultural Processing Objectives & Recommendations

Goal #2 above, which was specifically focused on value-added agricultural processing, was backed by five objectives and ten specific recommendations for action. The objectives called for:

- increasing incentives to promote producer investment in value-added agricultural processing;
- strengthening the North Dakota Agricultural Processing Utilization Commission (APUC);
- providing favorable finance programs for value-added agricultural processing businesses;
- promoting innovative financial tools to allow non-producer investment in value-added agricultural processing; and
- locating value-added businesses in rural areas if feasible, and preferably in North Dakota.

Specific recommendations included:

- asking Congress and the state legislature to provide tax incentives for producer investments in value-added processing projects;
- providing the Agricultural Products Utilization Commission (APUC) with a permanent source of funding and keeping the program primarily controlled by farmers;
- improving cooperative stock purchase programs so that greater incentives would be in place for low-equity farmers and improved loan terms would be available to farmers;
- developing a capital fund that would be partially funded by Bank of North Dakota earnings and that would invest in value-added processing projects;
- developing a mutual fund capital pool to attract non-farm investments in North Dakota value-added processing projects; and
- asking the state legislature to appropriate funds for the Partnership in Assisting Community Expansion (PACE) program that would allow for lower matching fund requirements from value-added processing projects.

The NDAREC printed copies of the report and included it in the September 1998 edition of the monthly magazine of the state’s rural electric and telephone cooperatives, “North Dakota REC/RTC Magazine”. The magazine has a circulation base of approximately 85,000.

Legislative Action
Initially, the bipartisan Commission introduced two major bills that encompassed its goals and recommendations. However, the initiatives ran into political problems when the Republican party criticized the proposals; Commissioner of Agriculture Roger Johnson is a Democrat whereas the Republicans controlled both the Senate and the House Agricultural Committee chairmanships. Components of the two major bills were consequently split into many smaller bills. Many of the bills that were related to the COFA’s goals and recommendations were voted down, mainly along party lines.

In September 1999, Jim Moench, COFA’s coordinator, indicated that COFA was regrouping so that it would be able to go into the next legislative session with a more bipartisan approach. He also indicated that COFA’s initial timeline of 2 years was too optimistic, and that instead the commission was looking at the possibility of a 5 year plan.

Regardless of the final results that may arise, the work and planning that COFA has involved represents another example of the efforts that North Dakotans have made to further value-added processing ventures in the state.

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Quentin Burdick
Center for Cooperatives

North Dakota State University’s (NDSU) Quentin Burdick Center for Cooperatives has helped to promote cooperative development. The Center was established in 1992 to conduct university education and research on cooperatives, to strengthen cooperatives’ operations, and to work towards expanding economic opportunities through cooperatives. Some of the Center's activities include participating in various cooperative development conferences, assisting cooperative businesses conduct market research, participating in tours throughout the state and elsewhere, and having guest speakers give presentations on cooperative and agribusiness issues. Past guest speakers have included executives with experience in American Crystal Sugar and North American Bison Cooperative, two of the region's new generation cooperatives. Some of the Center's staff members have helped to write several published NDSU Extension Service reports concerning new generation cooperatives and their members. The Center also carries out activities such as training sessions for cooperative directors and management. For instance, in 1999 the Center, in conjunction with the University of Minnesota’s Carlson School of Management, held an executive training program for directors and management of new generation cooperatives in Alexandria, Minnesota.

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Case Studies

The following NGCs are included here as case studies:

Dakota Growers Pasta Company
Northern Plains Premium Beef
North American Bison Cooperative
United Spring Wheat Processors (now Spring Wheat Bakers)

These case studies are included here to give an overview of the different circumstances and start-up processes that NGCs have experienced.

All efforts have been made to ensure the studies are as accurate as possible. Sources are included at the end of each case.

The Illinois Institute for Rural Affairs (IIRA), Western Illinois University, has compiled a directory of U.S. new generation cooperatives. This directory can be found online at the IIRA web page.

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Dakota Growers Pasta Company

Dakota Growers Pasta Company (DGPC) is an agricultural cooperative that processes its members’ durum wheat into flour and pasta products. The cooperative was incorporated on December 16, 1991 and became fully operational in 1994. By 1998, Dakota Growers was one of the three largest pasta producers in the United States, with facilities located in North Dakota and Minnesota. It has approximately 1,100 members located in North Dakota, Minnesota, and Montana. DGPC was one of the first successful new generation cooperatives in the 1990s. Their success has been an inspiration to others. Many new cooperatives have used DGPC as a model.

Industry Profile
Formative Stages of DGPC
Operations
Company Performance
Lessons Learned
Prairie Pasta Producers

Industry Profile

In 1998, the U.S. Department of Commerce reported that Americans had been increasing their pasta consumption at an annualized rate of between 2 to 3 percent for the past ten years. In the prior year, North American pasta consumption exceeded 5.0 billion pounds. On a per capita basis, pasta consumption has increased from roughly 7 pounds of pasta in 1984 to 14 pounds in 1994. The increase in consumption is primarily attributable to the fact that pasta is a tasty, relatively inexpensive food that is easy and quick to prepare and can be included in many types of dishes, including salads and main entrees. Products such as boxed pasta dinners and frozen pasta entrees have supported consumers’ demands for quick meals to prepare at home. Pasta consumed in restaurants has also grown as a result of the increasing trend for Americans to dine away from home. Pasta is recognized for its nutritional value; along with bread, cereal, and rice, the USDA includes pasta as part of the base of its Food Guide Pyramid. The USDA advises people to eat more of these foods than any other type on the Pyramid. In recent years pasta makers have also introduced new shapes and varieties of pasta to expand consumer choice. For instance, flavored pasta varieties such as tomato basil and lemon pepper have been brought into the market, pasta that does not require boiling before baking as a lasagna product has been introduced, and some makers have even started to market pasta as a dessert, introducing chocolate-flavored pasta. In the first half of 1994 alone, over 330 new pasta products were introduced.

There are three main market areas for dry pasta: retail, industrial, and foodservice. Approximately 63 percent of U.S. domestic production of dry pasta goes to the retail sector, 24 percent goes to the industrial sector, and 13 percent goes to the foodservice sector. The retail sector includes consumer retail operations such as supermarkets and warehouse club stores. In the retail market, pasta products are sold as both national or regional brand label products and private, store label products. Brand labels include Mueller’s, Creamette, Ronzoni, and Catelli. Brand label products represent about 80 percent of total retail sales and private store labels represent the remaining 20 percent. Private labels, however, have been increasing in popularity in recent years as consumers begin to accept these store labels as being similar in quality to brand name products. In some major geographic markets, store labels have already surpassed regional brands as the leader in sales.
The industrial sector of the dry pasta market includes food processors that use dry pasta as an ingredient in the foods they manufacture. In this segment, pasta is used to make products such as frozen dinner entrees, canned soups, and dry side dish mixes. Companies such as Kraft Foods, Campbell Soup, and Stouffers are included in this category. Many food processors in the ingredient sector choose to internally produce their own pasta for use in their end products rather than purchase it from external sources.

The foodservice sector includes food preparation operations such as restaurants, hotels, and airlines. Within this segment, foodservice distributors tend to act as middlemen, purchasing pasta from manufacturers and then selling the product to restaurants, hotels, etc. The foodservice sector has been growing in recent years, largely due to the fact that Americans are dining away from home more often; in 1996, Americans spent 46 percent of their food expenditures on away-from-home meals, compared to 39 percent in 1980.

The primary ingredient for pasta is semolina, which is milled from durum wheat. The volatility of durum prices will therefore affect manufacturers’ processing costs from year to year. The pasta industry is extremely competitive and price competition is intense. Therefore, pasta makers cannot easily increase their product prices when their costs of production increase. Because the semolina made from durum represents a primary input, pasta makers are significantly affected when durum prices rise. But the high level of industry competition also poses problems when durum prices are low. In a competitive industry, lower input costs will allow competitors to lower their product prices, and therefore put pressure on other companies to follow suit. Price competition such as this puts pressure on pasta makers’ profit margins.

The pasta industry has undergone significant transformations since the 1960s. Prior to that time, the industry was mainly comprised of family-owned regional companies. During the 1960s and 1970s, however, large conglomerates were expanding their product lines, and companies such as Hershey, General Foods and Pillsbury began to buy these pasta makers’ operations. Several years later some of these conglomerates began to divest of their pasta operations, selling them to others. In the process, some companies became even bigger players in the pasta industry, including Hershey and Borden. By 1997, Hershey had become the largest pasta maker in the U.S. In the mid-1990s, however, many firms began to restructure and shift their strategic directions. In 1997, Borden announced that it was leaving the private store brand label market and selling or closing five of its ten North American pasta plants. This opened the door for many newer companies, including American Italian Pasta Company and DGPC, to increase their market shares. In 1998, Hershey announced that it was selling its pasta business so that it could concentrate on its core line of confectionery and other grocery businesses instead.

Formative Stages of DGPC

There are only a few fully integrated milling and pasta manufacturing facilities in the U.S.; most pasta makers purchase semolina from independent milling companies. The idea of an integrated milling and pasta plant in the 1990s, however, was not new to North Dakota. In 1980, Noodles by Leonardo, a privately owned company headed by Leonard Gasparre, opened the country’s first such plant in Cando, North Dakota. It opened its second plant in 1992 in Devils Lake. The idea for DGPC partly came out of necessity; at the beginning of the 1990s, North Dakota durum producers were faced with low prices. The USDA’s National Agricultural Statistics Service reports that the market year average price for durum in 1990 in North Dakota was $2.50 per bushel. At this price, farmers were hardly covering their variable production costs. They wanted to find a way to add value to their durum.

In his USDA manual entitled Creating ‘Co-op Fever’: A Rural Developer’s Guide to Forming Cooperatives, Bill Patrie discusses the formation of DGPC. The North Dakota Economic Development Commission (the predecessor to the state’s Department of Economic Development & Finance) had unsuccessfully tried to lure a large pasta cooperative to the
The first meeting to discuss the formation of DGPC was held in August 1990, when three people met in Maddock, North Dakota. Bill Patrie, the newly-appointed director of the North Dakota Association of Rural Electric Cooperative’s Rural Economic Development Program, met with Bob Spencer, manager of Baker Electric, and John Rice, Jr., the president of the U.S. Durum Growers Association. They soon met with Eugene Nicholas, a member of the North Dakota House of Representatives, and Jack Dalrymple, the chair of the State House of Representatives Committee on Appropriations. Both Mr. Spencer and Mr. Nicholas had helped to arrange financing for Noodles by Leonardo through their roles in the Durum Triangle Industrial Park Corporation. These five men were the key organizers of DGPC. As of 1998, Jack Dalrymple, John Rice, Jr., and Eugene Nicholas were still involved with the company, serving on its board of directors.

DGPC organizers recognized two primary reasons why a cooperative structure would benefit durum growers: By belonging to a producer-owned cooperative in which delivery rights and obligations were attached to ownership, members would know that they had a buyer for their durum. Secondly, ownership would allow them to share in the incremental value added to their durum by processing it into semolina and pasta.

The organizers prepared an outline and budget for the feasibility work that needed to be done. Funding for the feasibility work was raised from the ND Wheat Commission, Central Power Cooperative, and Baker Electric to match a $25,000 grant that had been received from the North Dakota Agricultural Products Utilization Commission (APUC). A steering committee was formed, whose members represented the organizations that had provided funding for the study, as well as the U.S. Durum Growers Association, the ND Department of Economic Development & Finance, and the ND Farmers Union. Mr. Patrie served as the committee’s principal advisor. In 1990 the consulting firm of Senechal, Jorgenson, & Hale was hired to do the feasibility study. The study explained the advantages of using a producer-owned cooperative structure for a pasta operation. By January 1991 the study was completed and the results estimated that a minimum return on investment of 15 percent was possible.

The cooperative filed its articles of association in December 1991, and the steering committee was dissolved and replaced by an interim board of directors. Jack Dalrymple became its chairman (Mr. Dalrymple has since remained as chairman of the board). The cooperative hired legal, accounting, and business planning services, and received an additional $150,000 from APUC to help with the development process. With this grant, DGPC became the first business to receive funds from APUC's newly-created Cooperative Marketing grant category. The organization proceeded to hire Tim Dodd as CEO. Mr. Dodd came from the American Italian Pasta Company in Missouri, where he had been vice president of manufacturing since its commencement in 1988. American Italian Pasta Company is North America’s second largest producer and marketer of dry pasta. Dodd, who had also been the head miller for Noodles by Leonardo at one point, recruited the American Italian Pasta Company’s director of retail sales, Gary Mackintosh, and director of engineering, David Tressler, to join DGPC.

In January 1992, the company held a seed money drive in which 1,200 farmers contributed $.05 per bushel to indicate their level of interest in the cooperative. The contributions amounted to approximately $150,000, which matched the APUC grant.

**Initial Equity Requirements**

A business plan was completed, and the company determined that it would build a plant with an annual capacity of approximately three million bushels. An equity drive was planned, with the objective to obtain enough equity to finance 35 percent of the plant’s cost. DGPC determined the share price by dividing the amount of equity needed by the number of shares to be issued. The result was a price per share of $3.85.
The minimum individual producer investment required was set at 1,500 equity shares. At $3.85 per share, this amounted to $5,775. The cooperative held its first grower informational meeting in January 1992. DGPC received some unexpected publicity to help its equity drive when the media quoted the owner of Noodles by Leonardo as saying that farmers were too dumb and lazy to run their own plant. The comment angered Noodles by Leonardo’s durum suppliers, and the owner consequently ran a full-page apology in the state’s newspapers. After 33 equity drive meetings and an extension to its deadline, the cooperative reached its target to raise approximately $12.5 million in equity. The equity was raised from 1,042 durum producers, making the average individual investment approximately $12,000.

Each producer also had to purchase one membership share for $125. Voting rights arise from ownership of a membership share. No member of the cooperative can own more than one membership share. DGPC’s structure is based on the cooperative principle of one-member one-vote, which implies that all members have equal voting rights, regardless of the number of equity shares they may hold.

The majority of the debt financing for the cooperative came from the St. Paul Bank for Cooperatives, which granted the company a loan of over $20 million. DGPC’s board also negotiated a deal with the Bank of North Dakota (BND) to provide some financing on a subordinated basis to St. Paul Bank. The bank granted a loan of $6.5 million, but on the condition that only producers with a minimum net worth of $50,000 be allowed to join the cooperative, and that these producers give a personal commitment to cover any loan default. This was the largest loan that BND had ever granted. The cooperative had also received two zero-interest loans through the state’s rural electric and telephone cooperatives, each valued at $100,000. The estimated cost of constructing the plant was $40 million.

In June of 1992, Carrington, North Dakota was selected for DGPC’s plant location. Thus, the selection of DGPC’s first facility was not chosen until after the equity drive was completed. Carrington was one of 27 communities that had competed for the facility. Groundbreaking ceremonies for the plant were held in July 1992, and construction began in September. Bill Patrie estimates that the cost to get to this stage (the planning and development that took place between August 1990 and July 1992) was less than $500,000.

The plant was designed to have a capacity to grind 3,200,000 bushels of grain and manufacture 120 million pounds of pasta each year. It became fully operational on January 1, 1994. After running a deficit in its first operating fiscal year, 1994, the company has since been reporting profits. (As the fiscal year end is July 31st, fiscal year 1994 only comprised seven months of operations.)

**Operations**

DGPC began start-up operations in November 1993 with a single vertically integrated plant in Carrington, North Dakota and 180 employees. The plant was not fully operational until 1994. Initially, the plant had four pasta production lines and a capacity to manufacture 120 million pounds of pasta and grind 3,200,000 bushels of grain each year. In early 1994, DGPC relied on “co-pack” agreements and government customers for a significant portion of its sales. Co-pack arrangements occur between pasta manufacturers in all market segments for dry pasta. Under these arrangements, a pasta manufacturer sells dry pasta to another manufacturer so that the latter is able to meet any short-term volume deficiencies that may arise in filling its customer orders. The volume of these co-pack agreements has decreased since the DGPC’s start-up, largely due to the fact that the industry began to experience excess capacity and manufacturers were therefore not short of supply.


**1996 Expansion & Stock Offering**
Due to increased demand for its products, the cooperative announced in 1996 that it would expand its production capacity. This expansion would double DGPC’s milling and pasta production capacities, increasing the company’s share of total domestic pasta industry capacity from less than 3 percent to approximately 6 percent. Its milling capacity would increase from 4 percent to over 7 percent. The company managed to obtain a complete property tax exemption for five years on the property constructed in this expansion, and a partial exemption for four more years. The estimated cost of expansion was $20 million. In order to help finance this expansion, DGPC held a stock offering in January 1996. The company offered up to 500 membership shares at $125 each and 2,070,000 equity shares at $5.50 each (par value of $3.85) for sale. When the offering terminated in April 1996, the cooperative had issued 1,788,008 equity shares and 81 membership shares. DGPC received net proceeds of $9.72 million from the offering.

Expansion began in late 1996, and by the end of 1997, DGPC had doubled its original capacity. It could now grind 7,000,000 bushels of grain and manufacture 240 million pounds of pasta each year. It had six production lines and produced over 60 different pasta shapes, up from 55 the year before. Capital expenditures of $17.8 million were incurred in 1997, compared to $1.5 million and $1.3 million in 1996 and 1995, respectively. Expenditures in 1994 were $12.3 million, reflecting the remaining initial construction costs of the Carrington facilities.

The company also ordered an additional pasta line in July 1997 that was estimated to cost $5.5 million. This line, which became operational in July 1998, would add an additional 30 million pounds of capacity.

**Stock Split**

In August 1997, the cooperative’s directors voted in favor of a 3 for 2 equity stock split, in order to bring member durum delivery commitments in line with the expanded capacity of the plant.

**1998 Primo Piatto Acquisition**

Even with DGPC’s expanded capacity, it still found itself short of its production needs. In 1998, the cooperative decided to acquire Primo Piatto, Inc., a company that had been established in 1997 by a group of Borden employees who purchased two Minnesota plants that Borden was planning to close. The transaction cost $24.2 million. According to Tim Dodd, the acquisition created the largest non-branded pasta company in the U.S. Through this acquisition, DGPC expanded its operations into Minnesota. Primo Piatto’s physical assets included two production facilities specializing in retail production and a distribution center. The facilities contain a total of 10 production lines and have the capacity to process 200 million pounds of pasta each year.

With the acquisition of Primo Piatto, DGPC became the third largest pasta manufacturer in North America. By the end of 1998, DGPC was manufacturing over 80 different pasta shapes and had 493 full-time employees.

**1998/1999 Milling Capacity Expansion**

The Minnesota facilities did not include any milling operations, however, and DGPC had to purchase their semolina requirements on the open market. In order to supply enough of its own semolina to the newly acquired Minnesota plants, the company announced in 1998 that it would be upgrading its Carrington milling facilities. By providing its own semolina to all of its operations, the company anticipated significant cost savings and consistent quality in all of its products. DGPC obtained favorable long-term rail rates to ship the semolina from the Carrington mill to the Minnesota facilities. The upgrade would double the company’s milling capacity, raising it from 20,000 to approximately 40,000 bushels per day. The estimated cost
of the upgrade was $11 million. The mill expansion was completed in May 1999.

1998 Stock Offering

In November 1998, DGPC held another stock offering to help finance the mill expansion and to help reduce the debt load from the Primo Piatto acquisition. The equity shares were to be sold on a priority basis to existing members, and any remaining unsold shares would be offered to growers who wished to join the cooperative. The equity shares were offered at a per share price of $7.50 to existing members, and $11.00 to new members (if necessary). The price of a membership share was $125. An additional 345,570 equity shares were offered from selling stockholders, but DGPC would not receive any of the proceeds from these shares. The stock offering was completed February 28, 1999, and the cooperative had sold a total of 3,624,782 equity shares and 2 membership shares. After paying the selling stockholders their portion of the proceeds and the net costs of the offering, the company received over $24 million.

Grower Agreements & Durum Delivery

Each member is obligated to enter into a Growers Agreement with the cooperative. The Growers Agreement is used to ensure that a stable source of durum is available for the company’s operations. The agreement is tied to the equity stock: for each equity share held, the member is obligated to deliver one bushel of No. 1 hard amber U.S. durum wheat annually to the cooperative. DGPC has the right to reduce this delivery amount on a pro rata basis and will do so, depending on its marketing needs. The durum delivered must meet certain quality standards stipulated by the cooperative. The cooperative has established three, four-month marketing periods throughout the year. They are:

August 1 to November 30
December 1 to March 31
April 1 to July 31

For each marketing period, DGPC establishes the members’ delivery obligations. The cooperative gives each member notice of his delivery obligation for the upcoming period. In 1995, the cooperative utilized its power to reduce the delivery per share amount, decreasing it to .979 bushels per equity share. The delivery requirement was also slightly less than one bushel in 1996, 1997, and 1999. In 1998, the delivery obligation remained at one bushel per equity share for the year.

In 1998, the cooperative established a non-profit organization called Northern Grains Institute (NGI) to administer its delivery arrangements set forth in the Growers Agreement. Effective August 1st, 1998, a Durum Pool Agreement was established among DGPC, its members, and NGI to create a durum pool. All deliveries of members’ durum to the cooperative must pass through this pool. Essentially, NGI acts as each member’s grain handling and delivery agent: it arranges the logistics of durum delivery as well as payment and accounting matters.

Prior to each marketing period, DGPC establishes a projected average price (FOB Carrington) per bushel of durum for that period. Based on this price and the amount of durum that it will deliver in the member’s name to DGPC, NGI invoices the member. Each marketing period, the member is assigned by lottery a date on which he must settle this delivery payment. On or before that date, the member must make payment of the amount, which is equal to DGPC’s deduction for retainage on the durum to be delivered, plus a per bushel transaction fee. In 1998 and 1999 the deduction for retainage was 10% of the projected price per bushel for each period. The Growers Agreement allows for this amount to be as high as 20 percent. In fiscal 1997, the amount was 15 percent. The per bushel transaction fee was projected to be $.03 for fiscal 1999. This transaction fee will be refunded to the member if he sells and delivers under his own contract milling quality durum to NGI.
If delivery is not made by the grower and the contract requirement is unfulfilled, the transaction fee is not refunded.

Once the member has made payment of the invoice, NGI delivers durum to DGPC and receives the initial payment from DGPC on the member’s behalf. To the extent that its earnings provide the necessary funds and allows the cooperative to remain in compliance with its lending agreements, DGPC will pay directly to the members the amount of the retainage 45 days after the marketing period ends. Including fiscal 1999, the cooperative has never withheld a unit retain indefinitely.

The members make actual delivery to the durum pool by contacting NGI and arranging for a delivery date. NGI posts durum bids FOB Carrington on a daily basis. Within 14 days of delivery, the member is paid this DGPC spot market price for the durum. If the member is unable to grow and deliver the required amount of durum in order to fulfill his obligations, he must purchase the needed amount elsewhere for delivery to DGPC. In such a situation, the member is exposed to the risk that the price he must pay for the durum may be greater than the price paid to him by DGPC.

**Competition**

The pasta industry is extremely competitive and has undergone various changes within the past decade. In its 1998 prospectus DGPC reported that its main competitors included Borden, Hershey Pasta Group Division, and American Italian Pasta Company. The cooperative acknowledged that it competes against more established companies that have a greater amount of resources. In that year, eight companies, including DGPC, controlled over 50 percent of total industry production capacity. About a quarter of the domestic capacity comes from large established companies that manufacture pasta for their own end-use products. These companies include Kraft, General Mills, and Campbell Soup Co. Foreign competition is also present, including Italian, Turkish, and Mexican interests. Imported pasta represents approximately 12.5 percent of the domestic market.

The pasta industry has undergone various changes throughout the 1990s. In January 1999, Hershey Foods, the largest pasta maker in the U.S. at the time, sold its pasta business to New World Pasta LLC so that it could focus on its core business lines instead. In the prior year, Hershey held a 27 percent market share of the U.S. pasta market. In 1997, Borden Foods announced a major restructuring that included closing five of its ten North America pasta plants. At the time, Borden held about a 23 percent market share of the U.S. pasta market. The company announced another plant closure in 1998. Borden’s restructuring helped DGPC to gain a greater share of the private store brand label market segment.

With a few exceptions, most pasta manufacturers purchase their semolina needs from a third party milling company. DGPC and American Italian Pasta Company are major U.S. pasta producers that own vertically integrated milling facilities. Barilla, one of Italy’s largest pasta makers, has also recently completed construction of an integrated facility in Iowa.

In the cooperative’s opinion, there are five main factors that influence the level of competition. These are:

1) industry capacity utilization
2) product distribution costs
3) customer service
4) price of raw materials
5) ability to meet customer specifications with consistent quality.

DGPC believes that industry capacity utilization is the most important factor affecting the degree of competition. In 1999 there were estimated to be 60 to 65 major U.S. plants
producing dry pasta. Throughout 1996 to 1999, DGPC asserted that there was excess capacity within the industry. Companies were announcing their plans to increase capacity, either through expansion of existing facilities or construction of new ones, and foreign competitors were establishing North American operations. In recent years, many companies were repositioning themselves in the industry. As mentioned, Hershey announced it was selling its brand name pasta business, and Borden announced its plans to exit the private label pasta segment and close five of its ten plants. Meanwhile, one of Italy’s largest pasta makers, Barilla, was expanding its branded label marketing efforts.

Durum is the primary raw material used in pasta production; in 1996, it represented 48 percent of DGPC’s total cost of product sold. The volatility of durum prices will therefore affect the company’s processing costs from year to year. Since the company was organized, the price of durum steadily rose until the end of 1996. From 1995 to 1996, DGPC reported that the average cost of durum increased by 10 percent. In 1997, the cooperative reported the average per bushel cost had decreased by 12 percent, primarily because of a large durum harvest in 1996. In 1998, DGPC reported that its average cost of durum ground had unchanged from the previous year.

Because of the intense competition in the pasta market, pasta makers cannot easily increase their product prices when their costs of production increase. Because durum represents their primary input, pasta makers are significantly impacted when its price rises. But the high level of competition in the industry also poses problems when durum prices are low, because it puts downward pressure on pasta prices. DGPC asserted that intense price competition occurred in 1998 and 1999 as a result of low durum prices and excess industry capacity. Price competition such as this puts downward pressure on pasta manufacturers’ profit margins. Product price competition, particularly among branded products, has increased in recent years. In 1998, many brand name pasta companies were facing increased competition from store brands and imports. Consumers were beginning to recognize that the quality of store brands was similar to that of brand labels. With a decreasing average price for brand name products and the resulting decrease in price differential between branded and private label items, DGPC is concerned that its private label market, one of its major strengths, will face more competition.

Company Performance

In 1996, DGPC reported that its market share of the domestic dry pasta market was less than 3 percent. By 1997, the company reported that it had achieved an average annual growth rate of 38 percent since it began operations, and was one of the five largest pasta producers in the U.S. In 1998, DGPC, with the acquisition of Primo Piatto, Inc., reported that it had become one of the three largest producers in the country.

Net revenues and pasta volumes have increased every year since the company began operations in 1994. Volumes increased by 20 percent between 1996 and 1995, by 38 percent between 1997 and 1996, and by 61 percent between 1998 and 1997.

Since it began operations, DGPC has made a concerted effort to maintain a diversified customer base in order to limit its reliance on any single customer. In 1995 the company reported that two customers accounted for approximately 25 percent of total revenues, but by 1996 and throughout 1999, the cooperative reported that no single customer accounted for more than 10 percent of sales. DGPC’s sales mix has trended towards higher retail sector sales. By 1996, the company reported that the retail sector represented approximately 40 percent of its total pasta sales, while the foodservice sector accounted for 34 percent and the ingredient sector for 26 percent. By 1998, the retail sector had accounted for 55 percent of DGPC’s total pasta sales and the foodservice and industrial sectors accounted for 25 and 20 percent, respectively. In 1999, the breakdown was approximately 60 percent in retail and 20 percent each in the other two sectors. Most sales are done by purchase orders, in which the company and customer do not enter into any long-term agreement.
DGPC has concentrated its marketing efforts in the private store brand label segment of the retail sector, whose customers include U.S. food chains such as Stop ‘n Shop. In 1997, DGPC reported that its total store brand sales increased by 67 percent from the prior year. By 1998, the cooperative reported that it had the industry’s leading market share in this market segment, estimated at 37 percent. DGPC’s private store brand label business received an added boost when Borden announced in 1997 that it was exiting the private label market to focus on its branded product sales. DGPC’s own brand labels include “Pasta Growers,” “Pasta Sanita,” and “Zia Briosa.” In 1997, these brands accounted for 8 percent of the cooperative’s total sales. The "Pasta Growers" name has recently been changed to "Dakota Growers".

DGPC’s foodservice sector sales have experienced steady growth. This is largely due to the fact that the cooperative’s foodservice clients have benefited from the growing trend for people to dine away from home more often. DGPG’s customers in this sector have included The Olive Garden and T.G.I. Friday’s restaurant chains.

Within the industrial sector, DGPC estimates that approximately 75 percent of the needed pasta is manufactured by companies such as Kraft Foods for use in their own end products. DGPC has therefore focused its marketing efforts on the remaining 25 percent of the sector. The cooperative reported that sales within this market segment in 1997 had increased by 33 percent from the prior year, and in 1998 the number of customers had doubled. The cooperative has attributed its performance in the industrial segment to the consistency and uniformity of its product’s quality, two characteristics needed for pasta to be used as a food ingredient. DGPC’s pasta has been used as an ingredient in products such as Betty Crocker’s Hamburger Helper and Michelina’s frozen pasta dinners.

In addition to dry pasta products, the company sells any excess semolina and durum wheat flour to other pasta manufacturers. In recent years, however, this amount has been minimal; in 1999, less than one percent of the company’s net revenues came from these sales. The cooperative also sells byproducts from its milling process, such as millfeed and second clear flour that is used for animal feed.

The cooperative distributed its first patronage allocations in November 1995, which represented allocations for fiscal 1995 earnings. DGPC reported that fiscal 1998 was the fourth consecutive year that it had paid nearly 70 percent of net earnings to its members in the form of patronage dividends. A member's patronage is determined by the quantity of wheat he delivers to the cooperative.

**Selected Financial Data:**

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<th>Fiscal Year Ended July 31st</th>
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<td>(in thousands, except per share information)</td>
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<tr>
<td>Net revenues</td>
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<td>$50,494</td>
<td>$70,702</td>
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<td>Patronage and non-patronage earnings</td>
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<td>2,579</td>
<td>6,890</td>
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<td>Average equity shares outstanding</td>
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<td>Basic earnings per average equity share</td>
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<td>Total value of members' durum</td>
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<td>6.52</td>
<td>6.74</td>
<td>6.64</td>
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Lessons Learned

In its short history, DGPC has become a key player in the dry pasta industry. The cooperative attributes several factors for its success, some of which are the following: dedicated leaders and professional management, timing, dedicated members, a stable supply of its primary input, aggressive pursuit of a particular market segment, and a diversified customer base.

There is a commonly held view that one of the cooperative's primary strengths is its leaders and management. Three of the men who were involved in the initial organization of the cooperative are still with it today: Jack Dalrymple, Eugene Nicholas, and John Rice, Jr. all serve on DGPC's board of directors. Mr. Dalrymple has remained as Chairman since the cooperative's inception. Management has also remained; Tim Dodd, who joined the company in the beginning as its CEO, is now its President and General Manager. He also serves as second vice chairman of the National Pasta Association, and is in line to become its chairman in 2001. Gary Mackintosh, who joined in 1991 from American Italian Pasta as General Manager of Sales, is now its Executive Vice President - Sales and Marketing. David Tressler began as the cooperative's Project Engineer and is now its Vice President - Operations (North Dakota). The majority of DGPC’s officers came from other established pasta manufacturers, in particular Borden Foods and American Italian Pasta. DGPC has therefore had continuity in its leadership, as well as an experienced executive team.

Mr. Dodd has also noted that the timing of DGPC’s entry into the pasta industry was opportune. Growth in the demand for pasta was strong, and the level of competition in the industry was not as intense as it currently is. He expressed his doubts that a project could succeed if it started out small today, just as DGPC did in 1994.

DGPC attributes the dedication of its members as part of its reason for success. For instance, even though the agriculture sector was going through hard times, members still supported the cooperative in its 1998 stock offering and made that equity drive a success. By doing so, Mr. Dodd has said that members displayed their confidence in the cooperative, and their belief in owning a value-added durum processing business because durum prices alone are not enough to cover production costs.

DGPC also believes that its durum delivery arrangement with its members is a key strength of its operations. A commitment of members to deliver durum to the cooperative allows it to have a stable supply base of its primary raw material. This delivery arrangement also helps the cooperative to control the quality of its product, as the Durum Pool Agreement explicitly states the minimum standards that members’ durum must meet.

The cooperative's leading market share in the retail store brand label pasta segment is also recognized as one of its key strengths, especially since it represents a growing market. DGPC has aggressively pursued the private label market and believes that this sector is particularly important because consumers are beginning to recognize the comparable quality of store brand label pasta to that of brand names.

In addition to a leading market share in the retail private label segment, DGPC believes
that maintaining a diversified customer base has allowed it to perform well. Since its inception, DGPC's customer base has continuously expanded. By 1998 the cooperative had over eighty customers, including such established companies as General Mills, Safeway, ConAgra, and Costco. In that year, the cooperative’s top 10 customers accounted for 48 percent of its total sales, down from 56 percent the year before. As previously mentioned, no individual customer accounts for greater than 10 percent of sales. By maintaining a diversified client base, the cooperative has reduced its reliance on any particular customer.

Finally, the cooperative asserts that it maintains state of the art processing facilities in both its North Dakota and Minnesota locations. It uses advanced Italian pasta processing equipment that allows for efficiency in producing consistent, premium quality products. This advanced technology allows the cooperative to achieve lower production costs than competitors who have older, less efficient facilities.

**Prairie Pasta Producers**

In January 2001, Dakota Growers Pasta Company signed a memorandum of understanding with Prairie Pasta Producers, a Canadian grower-owned cooperative. To read more on this development, refer to DGPC's news release (the release is included on DGPC's web site, www.dakotagrowers.com).

Sources

Next

Back to Case Studies
Northern Plains Premium Beef (NPPB)

Northern Plains Premium Beef represented the efforts of a group of ranchers to establish a producer-owned, integrated beef production, processing, and marketing enterprise. The project was described by some at the time as the largest mobilization of U.S. cattle producers in the history of the industry. The enterprise was to produce and process high quality, source-verified beef. Complete vertical integration had never before been accomplished in the beef industry. After several attempts to raise sufficient capital, the enterprise failed to find enough support.

Industry Profile
Formative Stages of NPPB
Dissolution of the Cooperative
Lessons Learned

Industry Profile

The demand for beef products has been declining since the 1970s; although per capita meat consumption has grown, per capita beef consumption has dropped. Beef has been losing market share to poultry and pork for several decades; in 1975, beef accounted for roughly 48 percent of meat products consumed, while in 1997 its share had dropped to 32 percent. Many analysts have attributed the change in market share to the poultry and pork sectors’ ability to transform into consumer-driven industries and to achieve significant cost reductions that have translated into lower retail prices. They have accomplished this by achieving a high level of vertical coordination. Vertical coordination enables consumer preferences to be conveyed to every link in the production chain so that products can be tailored to meet their demands. Information sharing between production steps becomes key. The beef industry has lagged behind in this transformation to vertical coordination, and the result is that beef production is still geared towards a commodity-based product.

Part of the reason for this lag behind poultry and pork is the unique structure of the beef industry. The three primary links in the beef chain: ranchers, feeders, and meatpackers, are very distinct from each other. The cow/calf sector has a large number of relatively small producers: in 1998, producers with less than 100 head of cattle produced nearly half of all calves raised in the United States. More than 900,000 farms reported having some inventories of cattle at the beginning of 1998. The feedlot sector is also comprised of many players. Although it has been becoming more concentrated in recent years, about 110,000 were in existence in 1998. With such a large number of cow/calf operators and feedlots, vertical coordination between the two sectors has been difficult. The meatpacking sector, in contrast to ranchers and feeders, is highly concentrated. It is one of the most highly concentrated industries in the United States. In 1996, four firms accounted for approximately 80 percent of total fed cattle slaughter. The 1980s had witnessed a string of mergers that led to larger firms. In 1997 there were 812 federally inspected plants that slaughtered cattle, down from 1,350 in 1974. Today, three firms dominate the industry: Iowa Beef Packers (IBP), Monfort/ConAgra, and Excel/Cargill. Farmland National Beef Packing, which is completely producer-owned, ranks fourth.

The cattle cycle that began in 1991 was perceived by many producers to be worse than most previous cycles. In 1996, when the cattle inventory level peaked, several conditions were present that led to a lot of stress for producers. Peak cattle inventory levels and low cattle prices coincided with record-high feed grain prices. For instance, the USDA reported that the U.S. farm price of corn rose to $5.00 per bushel in July 1996, well above its 1994/95
average of $2.26. Feeder and fed cattle markets were experiencing negative returns. The USDA’s Economic Research Service reported that the sell-off of cattle in 1996 was accompanied by the second-lowest real net receipts above cash costs since 1913. In North Dakota, net returns per beef cow in 1995 and 1996 were almost a negative $50. Producers also saw reports of high profits for beefpackers and felt that they were being taken advantage of. There was concern among some producers and members of Congress that beef packers were using their concentrated market power to lower bids for cattle.

Cattle and calves represent North Dakota’s second largest agricultural commodity. The number of North Dakota farms reporting an inventory of beef cattle, however, has been decreasing. The number had declined from 21,891 farms in 1974 to 13,200 in 1993. Beef farms represented 51 percent of all North Dakota farms in 1974 but only 41 percent in 1987.

**Formative Stages of NPPB**

In 1993, a group of North Dakota producers and local economic developers began to talk about the need for a producer-owned beef processing cooperative. Such a business could provide producers with two streams of income: proceeds from the sale of their cattle to the plant, and a share in any profits from the sale of meat. They believed that quality was lacking in the marketplace, and that the northern plains states could produce superior quality beef. They felt that the lack of quality was partly attributable to the fact that producers did not retain ownership of their product throughout the beef system. Without ownership, the producers were not accountable for quality. They also perceived better product uniformity and predictable quality in the poultry and pork industries, whose products were beef’s competition. With a producer cooperative in place to market cattle, the flow of information back to ranchers could be enhanced so that products could be tailored to consumer preferences. Sharing information such as carcass data could improve quality and profitability, and tighter links between the different industry sectors could reduce production costs. If a link could also be made to the retail sector, then branded products could be developed. As is typical with the farm-value share of most agricultural commodities, the farm-value share of retail Choice beef prices has been decreasing over time. This is partly due to the fact that marketing costs have been keeping pace with inflation while cattle prices have not. Like many others, these North Dakota producers began to wonder why they did not have a direct link to the consumer. The producers wanted to venture past the stage of selling cattle on the hoof and expand into further value added activities. They formed a steering committee to conduct market research and to hire a consulting firm to perform a feasibility study.

At this point in time, cattle prices had not reached their low point in the cycle. NPPB asserted that the plan for the operation was not a knee-jerk reaction to poor cyclical prices. Rather, it was a visionary effort to develop a long-term approach in the industry. NPPB’s initial research efforts included meetings with Midwest and East Coast foodservice distributors and retailers to determine their needs and concerns. The results from these talks indicated that high quality and consistency were areas that needed to be improved within the industry.

In the spring of 1994, the Massachusetts firm of Senechal, Jorgenson, & Hale conducted a feasibility study. The study was to determine possible opportunities for a vertically integrated processing cooperative within the beef industry. The study’s results were favorable, assuming that the formation of marketing alliances occurred (p. 10 1997 circular).

In May of 1995, NPPB was successful in its bid to obtain a $150,000 grant from the North Dakota Agricultural Products Utilization Commission (APUC). $50,000 of this amount was contingent on support from the North Dakota Beef Commission. These funds would be used to develop a business plan and help organize the cooperative. The cooperative was legally formed in June of 1995.
Seed Money

In February of 1996, twenty-two informational meetings were held with potential members in order to elicit seed money for the project. The seed money was raised to help pay for the cooperative’s organizational costs and to ascertain the level of producer interest in the project. A deadline of March 1st was set for producers to indicate their interest by giving $1 per head of cattle, which would be used as nonrefundable seed money. Interested Canadian farmers were asked to put up $1.35 CDN. Producers were allowed to contribute past March 1st, but the amount per head was increased to $2 (approximately $2.70 CDN). The organizers’ goal was to determine whether there was enough interest to commit 300,000 head of cattle. The feasibility study had indicated equity shares were estimated to be priced at $47 ($63 CDN) per head of cattle, with only 300,000 shares to be sold. NPPB’s interim engineer had come from IBP, where he had most recently served as head of design, construction, and maintenance of its meat plants. Preliminary estimates indicated that the capital cost of a plant would be $35 million and that an average return on equity would be up to 15.9 percent. The site of the proposed plant would not be determined until after the equity shares were sold. The board of directors, who would be elected once the equity shares were sold and the membership established, would select the site.

As of mid-June 1996, seed money representing over 357,000 cattle from over 3,000 producers had been established. The majority of cattle represented came from North Dakota (approximately 112,000) and South Dakota (approximately 91,000). Seven states and two provinces were represented. Besides the Dakotas, Nebraska, Iowa, Minnesota, Montana, and Wyoming were represented. Manitoba and Saskatchewan were the two Canadian provinces. As a result of the successful seed money drive, NPPB established a five-person market opportunity research team. This group was formed to gather information that would serve as the foundation for the business plan, including the processing facility requirements.

On August 30, 1996, American agriculture secretary Dan Glickman announced that the USDA’s Federal-State Marketing Improvement Program would provide $75,000 to NPPB to help fund a business plan. In its press release, the USDA indicated that NPPB would provide about 800 jobs on the northern plains. Senators Tom Daschle, Byron Dorgan, and Kent Conrad; Congressmen Tim Johnson and Earl Pomeroy; and North Dakota Commissioner of Agriculture Sarah Vogel were all recognized by the USDA for their efforts in promoting NPPB.

The Plan

In September 1996 the cooperative hired an executive search firm, Robert Connelly & Associates of Minneapolis, to find a permanent chief executive officer to replace its interim officer, Bill Patrie. Mr. Patrie had significant experience in cooperative formation through his role as director of the North Dakota Association of Rural Electric Cooperatives’ Rural Economic Development program. The search firm initially reviewed over 100 candidates, and by the time the equity drive began in January 1997, it had narrowed down its list of finalists to 11 candidates. A chief executive officer would not be chosen until after the equity drive (p. 31 circular).

In November of 1996, NPPB issued a media release to announce that, after studying existing plants, the cooperative had decided to build two processing plants. (In its early planning stages, NPPB had examined an existing plant in Brandon, Manitoba as a possible location.) It felt that two plants would be better from a transportation point of view, so that producers from a broad area would not be disadvantaged because of their location. By this time, the cooperative reported that it had received total seed money contributions of approximately $488,000 from over 3,260 producers. The seed money represented approximately 431,000 head of cattle. NPPB had also received about $468,000 in various grants, including those from APUC and the USDA mentioned above. In total, therefore, NPPB had received about $956,000 from producer contributions and grants prior to
NPPB’s facilities would be designed like New Zealand processing plants. Two characteristics of these types of plants were chain speeds slower than those found in more traditional operations, and a teamwork approach to carcass fabrication rather than having individual workers perform single repetitive tasks. The cooperative’s plants were expected to process 25 to 30 head per hour, compared to 300 head per hour in for high-speed lines in certain conventional U.S. plants. NPPB wanted slower chain speeds to ensure greater quality control and that carcass data could be collected. This information would serve as valuable feedback to producers about the quality of their beef. Slower speeds would also help to improve worker safety, and the emphasis on quality rather than speed and the use of a team-based approach would reduce the rate of worker turnover. The cooperative also believed that slower speeds and the teamwork approach would lead to greater worker productivity. Smaller plants located in two different communities would also raise less environmental issues than one larger plant. Although the initial costs of building two plants would be greater than if only one larger plant was built, the cooperative felt that the benefits derived from the slower chain speeds and teamwork approach of the smaller plants outweigh the additional costs. NPPB hired a New Zealand consulting firm to help with the facilities’ design. Several of the cooperative’s board members and its engineer also went to New Zealand to tour some of the existing facilities.

**Niche Market Focus**

Rather than compete with the three giant firms in the general beef commodity industry, NPPB wanted to capture a niche market. It wanted to differentiate its products based on quality and consistency, and focus on the hotel and restaurant markets that were looking for higher quality cuts of meat. NPPB believed that there was a genuine demand from this sector that was going unfilled. At one point, the head chef of Marriott Hotels told NPPB’s CEO that thirty percent of customers complain about the quality of their steaks.

The National Beef Quality Audit of 1995 that was conducted for the National Cattlemen’s Association echoed many of the concerns about quality that were expressed by NPPB. The Audit reported that many of the purveyors, retailers, and restaurateurs surveyed had said that the beef industry was producing products with insufficient uniformity and consistency, and inadequate tenderness. They also felt that beef’s price was too high for the value received.

**The 1997 Equity Drive**

NPPB indicated that its proposed plants would each have a normal processing capacity of between 220,000 and 240,000 head per year. Accordingly, the cooperative was prepared to offer a maximum of 475,000 equity shares for sale. Each equity share represented the right and obligation to deliver one fed steer/heifer to the cooperative each year. NPPB planned to have seventeen equity drive meetings in January 1997, and a stock-offering circular was distributed at that time. The circular indicated that the obligation to deliver cattle was anticipated to begin in 1998. NPPB estimated that it would begin construction on the first facility in July 1997 and would be finished June 1998. The cooperative estimated that the second plant would be constructed beginning in July 1998 and completed June 1999. NPPB forecast that it could be profitable by the year 2000.

In order to have an efficient processing operation, NPPB determined that the equity drive needed to raise a minimum of 250,000 shares. The price of an individual share was $100 for those producers who had previously contributed funds to the cooperative (referred to as “Identified Producers”). For other qualified agricultural producers, the price per equity share was $110. Each individual also had to purchase a membership share for $200. The price of the membership had to be paid in full at the time the offering ended, which was scheduled for February 1, 1997. The price of the equity shares, however, was to be paid in two installments: For Identified Producers, $60 had to be paid on or before March 1, 1997, and the remainder
was due on or before March 1, 1998. For other producers, the amounts due on these dates were $70 and $40, respectively. It was reported that NPPB sought to raise $60 million in total, 40 or 50 percent of which would come from the stock offering. The rest would be arranged from lenders. The minimum investment required from each member was set at 25 equity shares.

Although NPPB’s primary goal was to construct two processing plants, its offering circular indicated three possible plans, depending on the number of shares sold:

1. If the cooperative sold a minimum of 250,000 equity shares but not more than 325,000 shares, then it would construct only one facility.

2. If the cooperative sold more than 325,000 equity shares but less than 440,000 shares, then it would construct one facility and pursue a joint venture, contract processing, or some other sort of arrangement to ensure that the amount of member cattle in excess of NPPB’s production capacity are processed elsewhere.

3. If the cooperative sold more than 440,000 equity shares, then it would pursue its primary plan of constructing two facilities.

The cooperative estimated that the cost to construct one plant, including provisions for working capital would be $56.2 million, and the cost to construct two facilities would be $109 million. Accordingly, if NPPB only raised the minimum amount of shares, then it would be required to seek approximately $31 million in debt financing to cover the remaining cost of constructing one facility. If NPPB raised the maximum amount of shares and built two facilities, then it would be required to raise $62 million in debt financing.

NPPB gained national attention when it was featured as a front-page article in The Wall Street Journal in March 1997. The article described the situation of ranchers in southwest North Dakota at the time, noting that cattle prices were so low that 85 percent of the ranchers qualified for food stamps, and that as many as half of them were behind on loan payments.

By March of 1997, NPPB reported that only 113,000 equity shares were raised from 1,055 members. This amounted to approximately $11 million. NPPB attributed this 137,000 share (approximately $14 million) shortfall to the harsh winter weather that was occurring on the northern plains. The cooperative had to reschedule twelve of its seventeen meetings because of blizzards (source: Patrie’s booklet). Producers were too busy just trying to keep their herds alive to attend meetings. Total cattle and calf death losses of 135,000 in 1997 were the second highest on record for North Dakota. Cattle losses of 45,000 head were the highest on record. The cooperative decided to continue with its equity drive until June 1, 1997, hoping that producers might be willing to commit more of their spring calf crop. NPPB also wanted to use the extra time to seek out strategic alliances or partners who would help to reach the needed 250,000 head count, and to work with lenders to ensure that potential members had access to share purchase loans. NPPB received an additional $47,000 from APUC to help pay for the equity drive extension.

On the day that the cooperative announced the equity drive extension to June 1st, NPPB also announced that it had hired a permanent CEO, Earl Peterson. Mr. Peterson had forty years of experience in the beef industry. He had recently retired from his senior vice president for administration position with the National Cattlemen’s Beef Association. The cooperative had finally found a permanent replacement for its interim CEO Bill Patrie, who had served in the position for the past year. Mr. Petersen felt that one of the possible reasons for the equity drive shortfall was that NPPB’s organizers might have been overly optimistic when deciding to build two plants.

USDA Loan Guarantees
On May 1, 1997, U.S. agriculture secretary Dan Glickman announced that the USDA would offer loan guarantees to help ranchers invest in NPPB. Canadian ranchers would not be eligible for this assistance. Through its Business and Industry Guarantee Loan program, the USDA would help secure loans made by banks to ranchers for the purchase of cooperative shares. This Business and Industry Guarantee Loan program was given expanded lending authority through provisions set forth in the 1996 FAIR Act. The purpose was to give the USDA authority to back loans to farmers and ranchers who wish to invest in new value added cooperatives. The USDA also reported that paperwork requirements for the Business and Industry Guarantee Loan program were slashed by fifty percent, part of the Clinton administration’s ongoing efforts to streamline the USDA Rural Development’s application and regulation procedures.

With the USDA guarantee program in place, Bill Patrie saw no reason that money should be an issue for potential NPPB investors. The potential problem was that ranchers were not well aware of the program. Confusion over the programs available to ranchers might have been another reason for NPPB’s equity shortfall. NPPB’s board directed their efforts toward educating lenders and potential investors about the USDA guarantee program.

**Equity Drive Fails**

The June 1, 1997 equity drive deadline passed, and NPPB reported that it had not met its goal. Investors’ $100 share investments were refunded. A total of 119,000 equity shares had been sold, still far below the 250,000 minimum. The average investment per rancher had been about 110 shares. NPPB cited the terrible winter weather, tough financial conditions in the region, and a general resistance to change among producers as three key reasons for the equity drive failure. Still, the effort represented what NPPB called “the largest, single mobilization of cattle producers in the history of the industry.”

**Member survey**

But the cooperative was not ready to give up. In September 1997 NPPB conducted a poll of its members to determine the next step that the cooperative should take. Half the cost of the survey was covered by the Dakotas Cooperative Business Development Center. In this poll, several options were presented to the members:

1. Dissolve the cooperative.
2. Change the cooperative to a supply organization that would form an alliance with an existing beef processor and supply cattle to its operations.
3. Go forward as a vertically integrated beef processing cooperative, but on a smaller scale than previously planned.

The poll’s results indicated that most members preferred the cooperative to move ahead as a vertically-integrated operation on a smaller scale. In December 1997, nearly 300 members gathered in Bismarck. At this meeting they voted in favor of making changes to the cooperative’s by-laws and reducing the size of the board from twenty-one members to eleven. They elected eight directors from four districts. Four of these directors were from North Dakota, three were from South Dakota, and the other was from Manitoba. The three remaining members were to be appointed by the board. Among the appointed was a new chairman, John Lee Njos, who replaced Dean Meyer. Mr. Meyer had served as chairman for the previous three years. Both of these chairmen were from North Dakota. The members in attendance also voted in favor of holding another equity drive after a revised business plan was completed. The new plan was to involve a smaller number of cattle than previously, and it would also select a site location before an equity drive was held. They hoped that this would be accomplished in early 1998.
The Revised Plan

NPPB decided to change its approach regarding facility requirements. Instead of building two plants, the cooperative was now looking to build one smaller facility. Once again, the facility was to be designed according to procedures followed in New Zealand plants. Early in 1998 NPPB’s chairman reported that, based on information from these New Zealand facilities, a plant processing as little as 100,000 head could be viable. The cooperative had not yet determined its production or carcass specifications. Potential plant sites in North and South Dakota were announced. Eight locations were invited to submit proposals to the cooperative: Dickinson, Bismarck-Mandan, McLean County, and Ellendale in North Dakota, and Aberdeen, Huron, Pierre, and Rapid City in South Dakota. By December 1997, the cooperative had narrowed down the potential site to McLean County, Rapid City, and the two-city area of Ellendale and Aberdeen.

Two other cooperatives that would complement NPPB were also in their formative stages. In January 1998 the North Dakota Farmers Union announced its plan to build an $8.1 million backgrounding feedlot that would handle 30,000 head. The group, named the Farmers Union Feedlot Association, planned to eventually operate two feedlots and expand into a finishing feedlot. The idea was that these cattle would be slaughtered by NPPB, in which the Association had become a member. Informational meetings about the cooperative were held throughout the winter, and a business plan was expected to be completed in the spring. In July the cooperative was working with consultants to plan an equity drive for the fall.

Another cooperative that was in the formative stages, Dakota Prairie Beef, might have been a source of cattle for NPPB. Dakota Prairie’’s objective was to establish a feedlot with a capacity to finish 10,000 cattle twice a year near Gascoyne, North Dakota. The finishing lot would feed cattle to their slaughter weight (approximately 1,200 pounds). It began its equity drive in January, and by the beginning of March the cooperative had over 7,000 cattle committed from 128 members. In March the cooperative elected a board of directors and the membership voted in favor of continuing the equity drive. In June, it was reported that Stark Development Corporation of Dickinson, North Dakota had agreed to purchase $20,000 worth of preferred stock. A local feedlot would make it easier for producers to maintain control throughout the beef system. A survey conducted by NPPB in late 1997 indicated that producers wanted to be involved in all aspects of delivering an animal to a processing plant. Controlling a feedlot operation would help to achieve that end. It was expected that many producers who planned to invest in the feedlot cooperative would also invest in NPPB.

A New CEO

The cooperative also had to begin looking for a new CEO. Earl Peterson, the previous CEO who was hired in March 1997, decided not to continue in this role because of family commitments. In April 1998 NPPB announced that it had hired Keith DeHaan as its new CEO. Mr. DeHaan came from Beef America, a packing and processing plant in Omaha, where he had been the vice president of technical operations for the past two years. Prior to that he had been with Farmland Industries for over twelve years. His last position with Farmland involved developing cow/calf to packing plant alliances. Based on conversations with several of his contacts in the marketplace, DeHaan believed that NPPB’s high quality products could be easily marketed.

NPPB felt that having a permanent CEO on board prior to the equity drive was a good move. In the first equity drive, a permanent CEO was not hired until the drive was well underway. With a CEO in place prior to the second drive, the cooperative felt that more credibility and leadership could be attributed to the project.

South Dakota Plant Site Selected

In April 1998 NPPB announced that the site of its proposed plant would be Belle Fourche,
South Dakota. Belle Fourche was chosen in part because it was an accessible location to most producers in the region. Advantages such as access to prospective members with outstanding genetics and existing water storage capacity were some of the reasons given for the site selection. The location was considered to have one of lowest utility costs in the country. There was an adequate cattle feeding infrastructure within a 200 mile radius of the plant, and the feedlots in the area would also facilitate NPPB’s hygiene standards, as they experienced less mud than others in the region. The choice of Belle Fourche was also well-suited to Dakota Prairie Beef’s proposed location. A finishing lot located in Gascoyne would be close to a slaughtering plant in Belle Fourche.

NPPB’s chairman indicated that producers had asked the cooperative to select a site prior to conducting an equity drive. Not having any site locations selected during the first equity drive might have been part of the reason for its failure; with a plant site selected, producers could have a clearer picture of where the facility was going to be in relation to their own operations. Selecting a site removed some uncertainty, and NPPB felt that producers would now be more willing to contribute to the project. Northern Plains received help from Northern Hills Community Development Inc. of Sturgis, South Dakota in selecting a site.

The cooperative also felt that the business plan used in the first equity drive was not as specific as it should have been. This second plan was more specific, and NPPB felt that this gave the project a more focused approach.

In order for the plant to be built, the cooperative reported that it needed to sell between 101,000 and 130,000 shares to producers based on its preliminary cost estimates.

By the second equity drive, NPPB made it clear that their objective was to focus on high quality, source-verified beef products for the hotel, restaurant, export, and gourmet retail market. Food safety would also be a fundamental part of their market focus. The cooperative believed that its direct producer connection and commitment to optimum hygiene and safety would help to make its products easily marketable. Food safety in the beef industry has always been a key public concern. The matter wasn’t helped much in the fall of 1997, when 25 million pounds of frozen hamburger from a Nebraska plant had to be recalled because of E. coli contamination. In 1997 NPPB worked with a firm that was trying to develop a technology that could identify tainted meat. Through a grant from Technology Transfer Inc. (an agency of the North Dakota Department of Economic Development & Finance) and contributions from NDSU and Dakota Technologies Inc., Massachusetts-based SatCon Technology worked with NPPB to develop its biological laser sensors. These sensors were being developed to detect contaminated meat in slaughterhouses.

The 1998 Equity Drive

NPPB’s second offering circular was dated May 26, 1998. The cooperative was offering a minimum 101,000 shares of equity stock and a maximum of 130,000. The cooperative scheduled ten equity drive meetings in North Dakota, South Dakota, Montana, and Wyoming to be held in June. The per share price of equity stock was $100 and a minimum individual investment of 40 shares was required. The stock offering circular indicated that NPPB’s system was capable of producing a 38 percent return on investment. The entire project would cost about $24 million, of which $17 million would be for the plant and $7 million would be for working capital. The cooperative estimated that it would need to obtain $14 million in debt financing. In order to accommodate producers’ cash flow situation, NPPB allowed the shares to be paid for in two stages: $50 to be paid during the summer equity drive, and the remaining $50 to be due January 1, 1999. Instead of paying the remaining $50 at that time, the member could choose to pay only $25 on January 1, 1999 and then pay $10 per share per year in 2000, 2001, and 2002. Once again, each equity share represented the right and obligation to deliver one fed steer or heifer to the plant annually. If the equity drive was successful, the cooperative estimated that it could begin construction in October 1998 and be completed September 1999. NPPB forecast that it could be profitable by the year 2000.
NPPB was very encouraged by the attendance at the informational meetings, but by the time the equity drive reached its July 15, 1998 deadline, only 30,000 shares had been raised from 300 producers, far below the minimum requirement of 101,000 shares. Both the chairman and CEO of NPPB were perplexed by the lack of support. NPPB’s board decided to extend the drive for sixty days, to September 15th. Among those who had invested, there were some that were extremely enthusiastic about the project. The cooperative hoped that they could garner support from others during the prolonged sixty days. The board also scheduled a meeting to be held shortly after the September deadline to dissolve the cooperative if it had not reached its needed share level.

Dissolution of the Cooperative

NPPB did not meet its minimum equity requirement by the September deadline, and in early October 1998 a membership meeting was held to dissolve the cooperative. The members voted in favor of dissolution, and the articles of dissolution were filed with the North Dakota Secretary of State.

The cooperative’s intellectual assets were to be given to a committee of trustees so that new ways to start up a similar project could be explored. A new group called the Dakotas Beef Marketing Project was formed to develop a venture that combined NPPB’s ideas with another previous study. The project was looking to form a partnership between producers and Cloverdale Foods. At the end of October 1998 the group went before APUC to request an $84,000 grant to help the venture develop a business plan and determine the size of the project. Bismarck’s Lewis and Clark Regional Council was helping with the APUC request. Unfortunately, APUC rejected their request. The Dakotas Beef Marketing Project became known as a non-profit North Dakota corporation called the Dakota Beef Development Corp. A group comprising its board of directors was established by the end of December 1998. The seven directors came from North and South Dakota. Among the board members were the presidents of the North Dakota and South Dakota Farmers Unions and the chairman of the former NPPB, John Lee Njos. Keith DeHaan, the CEO of NPPB, was acting as a consultant to the group.

Dakota Beef Development Corporation

In January 1999 the organization reported that they were working with a beef processor to develop a joint marketing plan. They wanted to market cattle through the existing processor. The group was to go before APUC again to request funds, but this time Dakota Beef had a strategic plan and felt they were more organized. The group requested $134,350 from APUC to help develop a marketing plan. In February APUC awarded $20,000 to the organization, well below the requested amount. Dakota Beef requested proposals from four different market research groups and chose Livestock Planning Associates, which is headed by Keith DeHaan. In May 1999 the Dakotas Cooperative Business Development Center, which is providing technical support to the project, reported that Dakota Beef was working with Rosen’s Diversified Meat Group to conduct a joint marketing plan. Rosen’s is an established packer-processor that is headquartered in Long Prairie, Minnesota. Dakota Beef is based out of Mandan, North Dakota. The marketing study was to determine the potential demand for high quality, producer-owned source-identified beef to high end users such as gourmet retail and food service purveyors. In July of 1999, Keith DeHaan indicated that the results of the study had been completed and were very positive. He has been hired to start on the business planning phase.

Lessons Learned

One of the key reasons frequently mentioned for the equity drive failure was that ranchers’ financial situation was just too strained to allow for investment. Many ranchers believed that they did not have $4,000 (the minimum required investment in the second equity drive) available to invest, and that borrowing and paying interest on the required amount for a
project that might not make it was just too risky at that time. Producers could not afford to invest in a project that might take years to show any positive results, if any. The low point in the cattle cycle had lasted longer than anticipated, and producers were too busy with their own operations to focus on the equity drive. Even NPPB’s former chairman, Dean Meyer, expressed his lack of confidence in the second equity drive. He also felt that the people who had been working on the project for the past four or five years might have been losing their energy and momentum. Disapproval with the choice of a South Dakota plant location might have been another reason for the lack of support.

According to NPPB’s CEO Keith DeHaan, a survey was conducted after the second equity drive to determine the key reasons why the cooperative failed. The survey results indicated five key reasons:

1. The cost of retained ownership every year would have been too much for producers. DeHaan estimates that the cost from weaning to finish are on average $300 per head annually.
2. Producers could not afford to let their debt to equity ratios get any higher at a time when income generation was so low.
3. Although a return on investment of 27% over seven years was estimated, this return would not begin until three years after the cooperative began. Producers did not have the financial durability to wait that long to see a return on their investment.
4. Many of the producers were older and planned to retire within the next ten years. They felt the project was a good idea, but just too late to help them.
5. There was just too much overt cynicism. Instead of taking a proactive approach, many producers would rather complain about their situation or support a program like R-CALF instead.

Based on the number of producers who showed their support during the seed money drive and the attendance at informational meetings, there is no doubt that the concept of a producer-owned beef processing and marketing cooperative on the northern plains was perceived as a good idea. The failure of Northern Plains Premium Beef to generate enough equity capital does not necessarily imply that producers disagreed with the general concept. Although it is difficult to pinpoint the exact cause for NPPB’s failure, several reasons are possible.

Producers’ financial situation has been repeatedly expressed as a primary reason for the failure to generate enough equity capital. Although the cooperative’s plans forecast positive returns several years after start-up, producers were not willing to strain their current financial positions more than they were already. As one writer has indicated, many producers were finding it difficult to see themselves surviving in the industry long-term. If these producers already thought they would only survive the agriculture business for a short while longer, they certainly wouldn’t invest in a long-term project. It has already been noted that many producers were nearing retirement. For them, investing in a project that would not provide benefits until later on was not worthwhile.

NPPB’s business plans might have been another reason for failure. Many producers did not like the fact that the cooperative had not selected its plant locations prior to the first equity drive. Producers wanted to know how their individual operations would fit in relative to NPPB’s locations. Without knowing the plants’ locations, key logistics could not be determined. Even though a plant site was chosen for the second drive, its South Dakota location might have been another reason for the lack of interest among producers. It is a natural tendency for producers (or investors in other industries, for that matter) to favor an operation that is located in their own state. People want to see the indirect economic benefits that accompany a business flow into their own communities. For this reason, North Dakota
producers may have felt that a South Dakota plant site was not advantageous.

In addition to plant location, proposing to build two facilities might have appeared overly optimistic to producers. Switching to a plan that proposed a single, smaller plant in the second equity drive might have caused producers to wonder if the cooperative was carefully planning its strategic approach, or just going from one idea to another. Building any plant at all might have also deterred some producers from investing; they might have preferred that the cooperative team up with an established processor who could provide the facilities and the processing expertise.

Changes in leadership might have also caused some consternation for producers. The cooperative did not have a permanent CEO in place when it began its first equity drive. In fact, Earl Peterson was not hired until the first deadline had passed. Although Bill Patrie had ample experience in cooperative formation, he would only be with NPPB temporarily. The cooperative also saw a change in its CEO position between the two equity drives. This lack of continuity in leadership might have led some to perceive a lack of clear direction and vision for the project.

Finally, the nature of ranchers themselves might have hindered the cooperative’s efforts. Ranchers are known for their independence. As well, there has always been a level of distrust among the different players in the beef industry. Asking them to work together on the project was a whole different way of doing business.

Although NPPB never became operational, the project brought together northern plains ranchers to discuss their future on a scale that had not been done before.

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North American Bison Cooperative

North American Bison Cooperative (NABC) was formed in late 1992 by a group of bison ranchers who wanted to establish a stable market for their bison and participate in the value added processing margins derived from the sale of bison meat. NABC constructed a processing facility in New Rockford, North Dakota and began operations in February 1994. It is the only USDA and EU approved facility in the U.S. that exclusively processes bison. NABC has helped to develop the specialty niche market for bison meat. Since 1994, the cooperative has expanded its facility at New Rockford and increased its membership. Today, the cooperative produces the largest supply of bison meat in the world and has over 330 members from 18 states and 4 Canadian provinces. In the year 2000 it is anticipated that over 10,000 animals will be processed by NABC.

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Industry Profile

Bison have a long and storied past in North America. A native species of the North American plains and the largest land mammal in this continent, the animal was the key source of subsistence for Native Americans. The bison provided food, clothing, shelter, and tools, and was a focal point for their culture. With the arrival of European settlers, however, the bison was hunted to near extinction. Estimated to number approximately 60 million in the mid-1800s, the North American bison population was decimated until it reached less than 1,000 by the end of the 19th century. Due to the efforts of some conservation groups and private ranchers, the number of bison has slowly increased since that time. The population was estimated to be at 30,000 in 1972; 98,000 in 1989; and in the late 1990s the number is estimated to be approximately 250,000. In North Dakota alone, the bison population increased from 5,000 in the late 1980s to 25,000 in 1997. Overall, the bison population is growing by approximately 20 percent per year. Because bison have become economically viable due to the demand for its meat, people have been given an incentive to raise the animals and increase the size of North American herds.

The number of bison available for slaughter is very small in comparison to mainstream meats such as beef and pork. When the cooperative was forming in 1993, Ken Throlson, NABC's president, remarked that if the same amount of bison were slaughtered per day as cattle, than the entire domestic herd of bison would be wiped out in one day. By the end of the 1990s, approximately 20,000 bison are slaughtered each year in North America, compared to 120,000 cattle each day.

The main attractions of bison meat are its taste, nutritional aspects, and connection to the Old West. If cooked properly, bison has a very sweet taste and is quite tender. Nutritionally, the meat has been found to be lower in fat, cholesterol, and calories than beef, pork, or chicken. Its protein content is similar to the others. Another aspect of bison that is appealing to some is its connection to the past; there is a sort of romanticism attached to the animal and its connection to the wild, open frontier.

In the early 1990s the bison industry was comprised mainly of independent hobby ranchers. Individual ranchers would slaughter their own animals and sell them to their particular groups of customers, or make arrangements with local small-scale processors. Because it was such a fragmented industry with no real organization or market structure, ranchers had little bargaining power in negotiating prices. There were limited marketing channels for bison meat, and individual producers were responsible for marketing their own products. Moreover, these ranchers often did not have the time or skills to develop marketing channels by themselves. Bison ranchers tend to be oriented more towards production rather than marketing. A cooperative could provide the marketing effort that they needed and would allow them to continue to focus on production.

Key Industry Problems: Supply, Quality, and Public Awareness

The fragmented structure of the industry led to several problems, the main ones being availability of supply and level of quality. Because the ranchers lacked coordination, there was no stable source of bison meat supply for commercial buyers. For instance, restaurants that wanted to offer bison dishes could not be assured that the product would be available on a regular basis. An individual rancher would not be able to provide a steady supply throughout the year because he would only slaughter at certain
points within the year. Without such supply assurances, restaurants were hesitant to list bison items on their menus. Even if
buyers did obtain bison meat, the product quality was often inconsistent because there were no uniform quality standards in the
industry. Inspection standards varied from state to state. Customers did not know what to expect from shipment to shipment, as
the quality widely varied. There was also little public awareness about bison meat because the industry did not do much marketing
and promotion of the product. Some people thought that the bison was actually extinct.

All of these reasons led ranchers to ponder the future of the industry at the end of the 1980s. With no uniform quality standards
or organized supply and marketing structure, many felt that the bison industry would never develop. In addition to these reasons,
the ranchers, like many other agricultural producers, began to wonder why they were not sharing in value added processing
margins. They wanted to move up the food chain into the processing stage, just like the sugarbeet growers and durum producers
had done. As NABC’s chief operating officer would later say, “Why should someone who handles the animal for two days make
more money than the producer who handled it for two years?”.

Formative Stages of NABC

A group of producers got together to examine the possibility of starting a processing business. Among them was Dr. Ken
Throlson, a veterinarian who became a full-time bison rancher in the early 1980s. Mr. Throlson would later become the president
and chairman of NABC, and has often been referred to as the project champion who led the cooperative through its early stages.
At the end of the 1980s Bill Patrie, who was then an economic development officer with the state, encouraged Throlson to
establish a processing cooperative. Mr. Throlson helped to promote bison production early on by setting up an information booth
at North Dakota’s "Marketplace" day in 1991 and teaching a seminar at the event in 1992. (Marketplace is an annual event that
helps to promote rural economic development in the state). A steering committee was formed, and in 1992 a feasibility study
was conducted by Senechal, Jorgenson, Hale & Company. Funding for the study came from producers, the North Dakota
Agricultural Products Utilization Commission (APUC), and the cities of New Rockford and Maddock, North Dakota. Don
Senechal, the firm’s consultant, estimated that the cooperative’s members could achieve a 47 percent return on equity. Based on
such a positive outlook, the committee was dissolved and replaced by an interim board of directors, and the cooperative was
legally organized on December 16, 1992. As with other emerging cooperatives, NABC received technical assistance and support
from Bill Patrie of the North Dakota Association of Rural Electric and Telephone Cooperatives. External financing for the
business came from the North Dakota Development Fund, regional economic development funds, local banks, and the Bank of
North Dakota, among others. After conducting market research and developing a marketing plan that eventually evolved into its
business plan, the cooperative was ready to move forward with an equity drive. The cooperative received another grant from
APUC to help with the membership drive.

NABC's Goals

NABC’s organizers had several goals that it hoped the business would achieve. Overall, they wanted it to bring some sort of
structure to a fragmented industry so that the market for bison meat could develop. By centralizing the processing and marketing
of bison meat, they hoped to establish a consistent and dependable source of supply that would give producers access to customers
who demanded minimum volumes of meat. They also wanted the cooperative to establish quality and grading standards that
would assure customers were getting a uniform and consistent product on every order. The organizers also wanted to promote
bison meat to potential consumers so that awareness of the industry would grow. By accomplishing these goals, the cooperative’s
organizers felt that they could provide a steady market for members’ animals and give them a fair price in return.

In an equity drive that lasted for approximately one month in 1993, the cooperative managed to raise over $1 million. The
cooperative used the Marketplace event in 1993 to help promote their offering. Approximately 180 members purchased 5,000
equity shares at $250 per share. One equity share represented the right and obligation to annually deliver one live bison to the
cooperative. The minimum individual required investment was 10 equity shares. (The maximum amount of equity stock that any
one member can own is limited to 10 percent of NABC's issued equity stock.) Each rancher was also required to purchase one
membership share that was priced at $100. Producers actively used the Bank of North Dakota’s Agriculture Partnership in
Assisting Community Expansion (AgPace) program to buy down the interest rate on loans they used to help build up their bison
herds. The program was used so much that the bank removed its categorization of bison ranching as “non-traditional” agriculture.
The cooperative did not choose a location for its plant until its membership drive was completed. NABC hired a plant manager in
the winter of 1993, who began working out of an office at the North Dakota Rural Electric Cooperative building in Mandan. The
cooperative received 49 applicants for the proposed plant site, and eventually chose New Rockford for the location.

In May 1993 the cooperative began construction on a $1.9 million processing plant in New Rockford, North Dakota. That
summer, NABC was the recipient of two $100,000 zero-interest loans from Dakota Central Telephone and Tri-County Electric, the
same utility cooperatives that provided loans to Dakota Growers Pasta Company. The facility was designed to meet EU
requirements and to handle an eventual capacity of 10,000 bison per year. The facility began operating in 1994.

NABC's Specific Objectives

From the outset, NABC set specific objectives to pursue. One of the foremost of these objectives was to control the worldwide
supply of bison meat. This has remained as a focal point of the cooperative’s strategy. By controlling supply, NABC felt it would
be able to maintain some control over the market price for bison meat. From its very beginning the cooperative set a goal to
control 60 percent of worldwide bison meat production. NABC also believed that in order to make bison products more attractive
to consumers, they needed to develop a fresh product market for the meat. Historically, most bison meat produced was marketed
as a frozen product. But people typically prefer to purchase fresh rather than frozen meats, so the cooperative considered
establishing a fresh bison meat market as essential for the industry to be able to move forward. NABC decided to aggressively
pursue the fresh product market; it wanted an even greater share of this market segment than its overall target of 60 percent, and set a goal to control 90 percent of the fresh bison meat sector. It was even willing to give up some market share in the frozen sector by providing other processors with frozen goods, so long as it would help to gain a greater portion of the fresh segment.

From its beginning, NABC also considered the export market as a focal point of its marketing plan. European consumers showed an interest in unique specialty meats such as bison, and they were typically accustomed to spending a greater portion of their income on food than were North Americans. With this in mind, NABC’s organizers constructed the New Rockford plant so that it would meet the certification standards necessary for exporting bison products. They directed marketing efforts toward Europe, attending a major trade show in Germany and distributing multi-lingual sales literature.

**Operations**

Although the cooperative had sold 5,000 equity shares that represented 5,000 bison to be processed each year, it did not require the full number of bison to be delivered until 1998. The reason for this was that the market demand for bison meat was exceeding available supply. One of the primary goals that NABC had in its beginning was to allow members time to build up their herds. If they didn’t, then the bison would be depleted too quickly and the cooperative would not be able to meet orders in the long run. NABC’s management was very careful not to take on more orders than it was able to supply.

In 1996 the cooperative doubled the capacity of the plant, increasing it to 10,000 head per year. It offered 5,000 new equity shares for sale in order to reach the 10,000 head capacity. By early 1998 NABC had sold all of its 10,000 available shares to producers. Due to the lack of bison available for delivery, however, NABC did not expect that the processing capacity level would be reached until 1999 or 2000. At the end of 1998 the cooperative began an equity offering to sell an additional 2,500 equity shares, so that bison commitments to the New Rockford plant would increase from 10,000 to 12,500 animals each year. This resulted from management’s decision that the New Rockford plant design could handle 2,500 more animals than the 10,000 originally projected. By 1998, the cooperative had added an additional $450,000 in improvements to the plant's original $1.9 million cost.

In addition to providing premium cuts of meat such as steaks and roasts, the cooperative uses its lower quality meat to produce products such as sausage, hot dogs, and jerky. NABC does not treat its bison with growth hormones, stimulants, or sub-therapeutic antibiotics so that customers are assured of getting a natural product. Producers must sign written affidavits witnessed by their veterinarians to attest that no synthetic growth stimulants were used, and all animals are checked for disease prior to processing. NABC also promotes the fact that all of its animals are ranch-raised. The cooperative sells to all sorts of customers, including private individuals, restaurants, grocery chains, and wholesalers. The cooperative also makes sales through a mail order catalogue. Recently, NABC has teamed up with another North Dakota cooperative to produce and market bison pasta products. Farmers Choice Specialty Foods based out of Leeds, North Dakota, and NABC have developed products such as bison ravioli. In 1999 the two cooperatives received a $152,300 grant from the North Dakota Agricultural Products Utilization Commission to develop further products and market them nationwide. The cooperative also sells bison by-products such as hides and skulls.

**Demand versus Supply**

During NABC’s early years the demand for premium bison meat has been exceeding the available supply. As a result, bison products have been relatively more expensive than beef. Quality bison meat can typically be two or three times the price of beef. Bison products have consequently appealed to higher-income customers and have been marketed as a specialty niche product. It should be noted, however, that lower quality meats such as ground bison (made from excess trimmings of the carcass) have been a tougher market to develop. In an effort to boost this market, the USDA’s Agricultural Marketing Service announced in March 1999 that it would purchase up to $6 million of ground bison, reported to be about one quarter of the bison industry's production of ground meat, through one of its food purchase programs.

**North American Provisioner**

Although NABC began its operations by functioning primarily as a wholesale distributor to other distributors, it has since recognized the need to strengthen its marketing efforts. NABC began to recognize the need to invest in a marketing infrastructure that would develop an aggressive marketing strategy to pursue new markets for bison products. With the supply of bison meat growing at an annual rate of 20 percent, the cooperative felt that strengthening marketing efforts was necessary to ensure that demand grows along with supply. In order to strengthen the bison industry, NABC saw that it had to make the same commitment to marketing as it did to quality production, and decided to use the proceeds of a December 1998 stock offering to help fund its marketing efforts. North American Provisioner, Inc. (NAPI) was established in 1999 as a wholly owned subsidiary of NABC to serve as its marketing arm. NAPI is headquartered in Omaha, Nebraska and its customer service support is based out of New Rockford. The cooperative felt that developing a brand name was an important part of its marketing strategy. With the help of a Minnesota ad agency, NAPI established the brand name “Buffalo Nickel”. The majority of products sold by NAPI are sold under this Buffalo Nickel brand name. In order to help promote the cooperative’s marketing efforts, members approved a checkoff plan at their 1999 annual meeting, in which 7 percent of the price they receive for their bison will be kept in the cooperative to support marketing activities.

Upscale, “white tablecloth” urban restaurants have been a key market for bison products. As part of its marketing strategy to this segment, the cooperative’s marketing company North American Provisioner has promoted its brand of bison meat as a product that should be used “to extend your menu with an easy-to-prepare specialty meat that offers the prestige of lobster, the versatility of chicken, and an alluring mystique of historical proportions.” If people begin to try and like high quality bison meat served in
these types of restaurants, then it is hoped that they would be more willing to purchase lower quality cuts such as hamburger in
grocery stores later on.

In 1999, North American Provisioner merged with U.S. Bison Co., the marketing company that was established in 1998 by
media mogul Ted Turner. Mr. Turner owns bison ranches himself and has been a member of NABC since 1996. Prior to the
merger, NABC had exclusive processing rights with U.S. Bison Co., which was organized to sell bison meat in the U.S. Southeast
market under the brand name “U.S. Bison”. After the merger, NAP will use two brand names, Buffalo Nickel and U.S. Bison.

Delivery & Payment

NABC will typically arrange for transportation of the animals to the facility. If not, the cooperative provides a mileage
allowance to the member so that he or she can arrange their own transportation. The cooperative covers all border crossing fees
associated with bison from Canadian members. NABC consults with producers when planning the delivery schedule so that each
members’ particular animal development patterns are taken into consideration. The cooperative mails out "Intent to Deliver"
forms to members who fill them out, indicating their anticipated monthly deliveries for the upcoming year. Based on the
information provided by these forms, NABC creates a delivery schedule for the New Rockford plant. Every member must enter
into a Producers Agreement, which is a contract between the member and the cooperative that binds each member to annual
delivery of live bison to NABC. The number of animals to be delivered is equal to the number of equity shares held by the
producer. The Producers Agreement also outlines issues such as pricing arrangements and any remedies to be taken in the event
that a member fails to make delivery.

Payment to producers is made upon sale of the bison meat. Interest is paid to producers between the time the animal is
slaughtered and the member is paid. Producers are paid the "market value”, which is determined according to the quality and
quantity of the delivered animals multiplied by the applicable average local market price, which is set annually by the board of
directors. The board sets this price every fall for the upcoming calendar year, based on its business judgment of projected market
conditions. Later additional payments may be made at the discretion of the board. Through any declared patronage dividends, the
members have the opportunity to share in any marketing price increases or decreases above or below the annually set average price
that may occur during the year. Quality is measured according to standards that include the animal’s carcass hanging weight, fat
content, fat and lean color, and bone ossification.

If a member fails to deliver the quantity of bison stipulated by the number of equity shares held, then he or she must purchase
the deficient amount of bison elsewhere and deliver it to the cooperative. Otherwise, NABC has the authority to purchase bison to
fulfill the member’s requirement and will charge the member for any related loss.

Competition

In terms of competition from other entities within the bison processing industry, NABC believes that it has established a
significant barrier to entry because of its control of the bison supply. In fact, the cooperative feels that its member delivery
commitments are one of its key strengths. With the majority of available bison under contract with from its members, the
cooperative feels that a competitor would have trouble obtaining enough bison to make opening a processing plant economically
viable. Although the bison meat industry is comprised of hundreds of small marketers, a substantial portion of sales are handled
by two larger companies, Denver Buffalo Co. in Colorado and Durham Meat Company in California. NABC has followed a
strategy of conducting business with these other entities by becoming a supplier for their wholesaling needs.

The cooperative does not feel that it has any significant competition from mainstream meats such as beef, pork, and poultry
because they are not perceived as substitutes for bison.

Performance

In its first year of operations, NABC processed roughly 25 percent of the worldwide supply of bison meat. By its second year,
the cooperative was processing between 35 and 45 percent of worldwide production. In terms of actual numbers, it has been
reported that NABC processed 1,700 bison in the first year. In 1995 roughly 2,500 were processed, representing about one-third
of worldwide production. Although it had relied on one marketing agent located in Minneapolis during its first year, the
cooperative began to use a number of representatives located throughout the world. This change in marketing structure helped
NABC to increase sales and its customer base so that it would not be reliant on a handful of key customers. By 1996,
approximately 4,500 bison were slaughtered and retail sales exceeded $8 million. The animals came from as far away as 1,500
miles from the plant. In that year, the cooperative doubled the capacity of the New Rockford plant, increasing it from 5,000 to
10,000 bison per year. By 1997, the cooperative was processing roughly 6,500 bison, or about 50 percent of worldwide
production. It had sales of over $10 million, and a membership base of approximately 250 ranchers from 14 states and 4 Canadian
provinces.
After three years of operating losses, NABC reported a modest profit for the year ended January 31, 1998. It paid its first dividend that amounted to $41.06 per bison delivered. In the same year the cooperative announced that it was planning to build a second facility within the next few years and appointed a committee to determine the location for the plant, which would most likely be somewhere in Canada. By the end of 1997, NABC was processing 140 head of bison per week. In 1998 the cooperative began to kill and process on a daily basis rather than its previous schedule of two to three days per week.

By 1999, the cooperative has met its target of controlling at least 60 percent of total worldwide production. It has also met its objective concerning the fresh meat market; by 1997, NABC reported that over 95% of its production is sold as fresh meat products.

NABC has made a concerted effort to develop its export market. In its first year, exports represented less than 5 percent of total production. By the end of 1996 they had increased to roughly 10 percent, and by 1997, between 20 to 25 percent of the cooperative’s products were exported to Europe.

The cooperative’s equity shares have been increasing in value. Initially, the price per share was $250. In July 1996, the price per share was reported to be $375, and by December 1998 the price had risen to $500. As of April 1999, NABC was reported to be planning another stock sale within the next year so that the cooperative is able to build a second processing facility. In a press release dated November 1, 1999, the cooperative announced that the second facility will tentatively be built in North Battleford, Saskatchewan.

Lessons Learned

North American Bison Cooperative is an example of a new generation cooperative that was successful in entering an undeveloped niche product market. It perceived the need to establish a company that could provide structure to an emerging industry and allow the industry to develop. The opportunity for a new company existed and the timing was right. NABC feels that its closed membership structure and delivery commitments from members have been key factors in its success. By contracting with members to deliver bison to the cooperative, NABC has managed to control a good portion of the supply of bison meat entering the market. The company set aggressive goals to pursue from the beginning, both in terms of market share and
quality standards. According to Dennis Sexhus, the cooperative's chief executive officer, NABC has accomplished the following:

- It has provided a fair price for the members’ bison.
- It has allowed members to participate in value added margins from the sale of processed bison products.
- By creating a guaranteed market for the members’ bison, the cooperative has reduced some of the uncertainty concerning where the ranchers can sell their products.
- Because the cooperative is responsible for processing and marketing their products, it has allowed members to concentrate their efforts on production activities.
- It has facilitated better banking relations for members because lenders now see that there is in fact a market for bison.
- It has contributed to the North Dakota economy. By 1996, the New York Times reported that bison represented a new $50 million industry to the state. It has also led to the establishment of many new commercial bison ranches in the region. The increase in the price for breeding stock has also been attributed to the cooperative’s presence.
- NABC has promoted the bison industry, especially because of the media attention that it has received. The cooperative has received press coverage from organizations such as the New York Times, CBS, and media groups from Europe.

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United Spring Wheat Processors

United Spring Wheat Processors (USWP) was formed in March 1996 by a group of producers who wanted to find a way to add value to their spring wheat. The experience of USWP is unique because it was formed before even knowing what line of business it would pursue. In fact, a successful membership drive was held before the cooperative had a business plan in place. In its initial stages, the organizers only knew that they wanted to organize spring wheat growers from across North Dakota, South Dakota, Minnesota, and Montana to develop a large-scale value added project. USWP began operations in June 1999, when it opened a frozen dough and frozen par-baked bread products plant in McDonough, Georgia. It also changed its name to Spring Wheat Bakers, but for the purposes of this article the cooperative will be referred to as USWP.

Industry Profile

Formative Stages of USWP

Lessons Learned

Industry Profile

The primary wheat grown in North Dakota is hard red spring wheat; in 1995, North Dakota harvested 8.2 million acres of hard red spring wheat out of a total wheat harvest of 11.1 million acres. Along with durum, spring wheat is particularly adaptable to North Dakota's relatively cool and dry climate. Hard red spring wheat is generally higher in protein and has greater gluten strength than other classes of wheat. Hard red spring wheat is used to make high quality bread products, and it is typically blended with wheat classes that have less protein content to enhance their quality. Products such as tortillas, bagels, pizza crust, and specialty breads use higher protein wheat flours.

In recent years the demand for wheat-based products has increased. A 1995 study done for the North Dakota Agricultural Products Utilization Commission identified several factors that were helping to increase the demand for wheat based products. The USDA had revised its Nutritional Recommendations so that more grain based foods were included, and consumers were becoming more health-conscious and selective in their food choices. As well, new baking technologies needed to use high quality, high gluten spring wheat-based flours. USWP’s choice of business to pursue as a spring wheat processor included becoming a baker, food services operator, frozen dough maker, or some sort of grain-based food products manufacturer.

Formative Stages of USWP

The initial organizers of USWP were leaders in the spring wheat industry and value-added cooperative ventures. Mike Warner, USWP’s chairman, has referred to the selection of the steering committee members as the most important step in the development of the cooperative. USWP wanted to establish credibility with potential members. In order to do this they needed a steering committee comprised of people who were well-reputed and known among spring wheat growers. The steering committee was comprised of 50 individuals from North Dakota, South Dakota, Minnesota, and Montana, and included those who had previous experience in value added cooperative formation. Among them were Jack Dalrymple and Eugene Nicholas, two of the original organizers of Dakota Growers Pasta Company; the chairman of ProGold, Pat Benedict; and the vice chairman of ValAdCo, Francis Buschette. Three former board members of American Crystal Sugar also joined the group. The
Committee members also included current and past presidents of the states' wheat promotion commissions and wheat growers associations, including the past president of the National Association of Wheat Growers. In a 1996 issue of their official publication Prairie Grains magazine, the Minnesota Association of Wheat Growers, North Dakota Grain Growers Association, and South Dakota Wheat, Inc., noted that they were driving forces behind USWP's formation. Other farm organizations were also represented on the committee. In order to display their commitment to the cooperative, steering committee members received no per diem allowance for their efforts. They wanted to show potential members that they believed in the project and were not doing it for temporary financial rewards. USWP used their committee members' reputations as a promotional tool for the cooperative; their resumes were included in brochures distributed to spring wheat growers.

USWP's Unique Approach

From the very beginning, USWP's organizers decided that the cooperative would follow a different development sequence than those that had come before it. As its chairman describes it, USWP was initially formed as a business whose sole purpose was to find a business. With a solid capital base in place, the membership would be able to hire competent personnel to examine the options for adding value to their spring wheat. By developing a membership and capital base before choosing a line of business, they also felt that the cooperative could build greater credibility among potential customers.

USWP's organizers wanted to secure a potential customer base prior to establishing a facility. They also felt that developing its membership was a good first step due to the widespread geographic dispersion of spring wheat growers in the region. By gathering the growers together at the very beginning, USWP could build a cohesive membership that would support the cooperative throughout its development. This was also important given the potential size of the membership; the organizers indicated that if only 10 percent of the approximately 30,000 spring wheat growers in the four states joined, the cooperative's membership would be larger than that of its predecessors, including American Crystal Sugar and Dakota Growers Pasta.

From the outset, USWP's organizers believed that the formation of a business would be an expensive undertaking; they estimated that the cost to hire key management and prepare a business plan would be around $1 million. They made this clear in their informational meetings held with potential members, so that there would be no surprises later on. In the beginning they indicated that the scale of business that the cooperative undertook might reach the $100 million to $300 million level.

The Membership Drive

Stage One: “Seed Money”

USWP's organizers scheduled grower informational meetings to be held in March and April 1996. The cooperative received a $100,000 marketing grant from the North Dakota Agricultural Products Utilization Commission (APUC) to help with the sign-up campaign and start-up legal and accounting fees. Of this amount, $50,000 would have to be matched by other private groups. If the cooperative did not choose to establish a plant in North Dakota, then the $50,000 would have to be refunded to APUC. Prior to the start of the grower
meetings, USWP representatives met with agricultural lenders in the region to make them aware of the project, so that they were prepared if growers came to them for assistance with purchasing shares. Approximately 45 grower informational meetings were to be held in North Dakota and Minnesota, and one was to be held in South Dakota. Montana was not included at this point because of delays in getting clearance from the state’s securities regulators. Potential Canadian members would not be sought because of trade and potential legal issues. The cooperative set up a 1-800-number phone line to answer questions and provide information to interested growers.

At the informational meetings, producers were asked for a $5,000 investment to establish their membership in the cooperative. The amount would be due in two installments: the producer was only required to contribute $200 prior to April 30th. This initial installment would be used as seed money for the cooperative during its organizational stage. The money would be used to conduct industry analyses and locate a CEO. The remaining $4,800 was to be collected in the fall of 1997. In order for the project to move forward, USWP’s organizers estimated that at least 2,000 producers would need to commit $5,000 each by that time. By April 18th, Mike Warner reported that the cooperative had distributed 8,500 seed money agreements to interested growers. By April 24th, it was reported that about 1,250 farmers had each contributed $200 for a total of at least $250,000. Company literature indicated that a minimum return on investment of 15 percent would be targeted.

USWP’s organizers hoped to attract 2,000 to 3,000 members. The $200 initial amount represented a right to become a member once the cooperative was formed; the producer would not become an active member until the remaining amount was collected in the fall. The $4,800 investments would be placed in an escrow account, of which the interest earned would be used to fund the business planning stage and hire an executive. Mike Warner estimated that a $10 million escrow fund could generate $750,000 in annual interest that could fund a three-year planning process. Once the business plan was completed and presented to the producers, they would be given the chance to approve or reject the plan. If rejected, the $4,800 investments would be returned to the producers. If the producers approved of the plan, then they would be given the opportunity to transform the $4,800 investments into equity shares.

From the beginning, USWP’s organizers set a definite deadline of September 30, 1999 to bring a project proposal forward to the members.

By the April 30th deadline, approximately 4,200 spring wheat growers from North Dakota, South Dakota, and Minnesota had contributed the initial $200 investment to the cooperative. Roughly the same amount of producers had attended the informational meetings, and USWP's organizers noted that many of them were under 50 years of age. The majority of the producers were from North Dakota (57 percent) and Minnesota (38 percent). As is typical with most seed money drives, the majority of the funds did not come in until the week before the deadline; Mike Warner estimated that approximately two-thirds of funds came in the last week. As a result of the successful drive, USWP continued to conduct customer-specific market analysis and moved forward with its plans to hire executive management and develop a business plan. The cooperative wanted to develop a plan that would provide its members with a minimum return on investment of 15 percent.

By November USWP had obtained approval from Montana’s securities regulators. USWP consequently held informational meetings in the state. Almost 800 interested producers attended the meetings. These growers had until mid-December to invest the initial seed money requirement.

CEO Search

In May 1996, the cooperative hired a Minneapolis-based executive search firm, Robert Connelly & Associates, to conduct a nationwide search for a chief executive officer (CEO).
This was a critical step for the cooperative. Although they knew that they wanted to add value to their spring wheat, USWP’s producers also knew that they did not possess the required skills and knowledge to start a business. As its chairman Mike Warner has stated, “The trick to starting any business does not hinge on what you know, but knowing what you don’t know”. They knew that they didn’t have the necessary skill set, and sought to hire someone who did. They were looking for an individual who had experience in the industry and who was well known by potential customers. The Minnesota Association of Wheat Growers provided support to the board of USWP until a CEO was found.

In November 1996, the cooperative announced that it had hired Gary Lee as its CEO. Mr. Lee’s last position before joining USWP was as vice president for Cargill’s Dry Milling Worldwide division, where his responsibilities included business and market planning and value-added product sales. He had also been involved with Cargill as an internal marketing consultant and strategic planner, holding such responsibilities as developing new product lines and market approaches for Cargill Foods. Mr. Lee was also named president of USWP.

Stage Two: “Credibility Money”

In late January 1997 the cooperative held meetings in all four states to solicit the remaining $4,800 investment from producers, so that it could proceed to the business development phase. Mike Warner has referred to these investments as “credibility money” because they would signify to outsiders that the cooperative and its members were serious about becoming a value added processor. At these meetings, USWP’s leaders, including its newly appointed CEO, discussed the cooperative’s structure and how the interest earned from the $4,800 investments would be used. If producers were unable to attend, a disclosure information package was mailed to them. The deadline to submit the remaining $4,800 to the cooperative was February 10, 1997. Producers would have the option to convert their $4,800 investment into equity stock once the cooperative completed a business plan and presented it to them for their approval. By the time the February deadline had passed, USWP reported that over 3,200 spring wheat growers had contributed the $4,800 individual investment, thus raising over $15 million for the cooperative. The result was more than double what USWP’s organizers had expected. North Dakota comprised roughly 55 percent of the membership, followed by Minnesota at 30 percent, Montana at 10 percent, and South Dakota at 5 percent. USWP consequently moved into its business development phase, and in March 1997 Lee reported that he expected to present a business plan to members by the end of the year.

Why did USWP conduct a membership drive before knowing its line of business?

One word to describe why the cooperative decided to hire a well-known CEO and amass $15 million in funds before knowing what it would manufacture is: credibility. Mike Warner has described credibility as "the most precious commodity you will need for success". USWP wanted people to know that it was serious in its intentions to become a large scale value added processor, and they felt the best way to accomplish this was to have a significant amount of money backing their words. Actions, they believed, could speak louder than words. The cooperative wanted to develop credibility with three key groups: potential employees, lenders, and customers. USWP wanted to hire quality personnel, and they felt that they needed to have a solid capital base in place before people would be willing to give up their current positions to work for the cooperative. USWP also wanted lenders to know that they were serious, not only to obtain financing for the business, but to ensure that lenders would be willing to help growers purchase stock in the cooperative. The most important group to establish credibility with was potential customers. USWP’s success would ultimately be determined by their decisions, so it needed to prove to them early on that it was a serious contender for their business.

Business Development Phase

USWP’s goal at this stage was to choose its core line of business. The cooperative
considered the key issues surrounding the market for spring wheat products, and noted the following:

- Consumers were beginning to demand a greater variety in their food choices, and they were increasing their purchases of flour-based foods.
- There was a shortage of skilled bakers. This shortage was affecting all bakery segments, including grocery stores' in-store bakeries, food service, and retail bakeries. As a result, the industry was shifting away from “scratch and mix” baking towards the use of frozen dough and partially-baked (par-baked) products. By using frozen products, companies would not have to worry about finding and retaining skilled labor that understood baking requirements such as formulations, mixing, and proofing times.
- No individual company or group of companies was dominating the frozen dough and par-baked market. USWP estimated that the top four manufacturers held about 23% of the market. It also believed that opportunities existed for a new entrant to gain a quality advantage over competitors.

In September 1997, USWP announced that its core strategy was to become a leading manufacturer of frozen dough and frozen par-baked products. Its product line would include high quality European and artisan-style crusty bread products, and it would focus its efforts on the $4 billion wholesale bakery market, whose companies serve the retail bakery market as well as in-store bakeries and food service operations such as restaurants. USWP believed that this market would grow by 5 percent annually for the next five years. One of the key reasons for market growth was that frozen dough products were gaining acceptance as an alternative to fresh-baked products. In recent years, many smaller companies have entered the frozen dough market, leading some to conclude that excess capacity exists in the industry. USWP felt that basing its decision on total capacity numbers would not be appropriate, as it perceived that quality was lacking in the industry. It felt there was an opportunity to provide a level of quality that was lacking in the market.

The cooperative's plan would be carried out over several phases and would require approximately $60 million, of which $31 million would be grower equity. Phase I of the cooperative’s plan involved the construction of its first plant. If it raised its targeted level of equity, the cooperative would be able to accomplish the first phase of construction without using any debt. USWP felt that starting up the facility without the use of debt would allow the cooperative to obtain better loan arrangements in the future. If it proved itself as a viable business early on, it felt that lenders would be willing to give it better loan rates when the time came for the cooperative to borrow. The first plant would be designed to handle future expansion, possibly for a bagel production line. Phase II would involve the construction of a second plant. This second plant would cost approximately $30 million, and would be financed with the use of debt. The cooperative hoped that this second plant would be built as early as 2001, after the first facility was operational and its performance was evaluated. Once the two plants were in operation, over 5 million bushels of spring wheat would be used annually. Until then, USWP hoped that it could sell some of the excess flour produced from its members’ annual 5 million bushels of wheat. USWP indicated that it would not own its own mill. One of the key reasons for this decision was the intense competition found in the milling industry.

Overall, the cooperative's analysis estimated that it would exceed its original 15 percent return on investment target. A return of 6 percent was expected for the first year of operations, climbing to 25 percent by the year 2001 and 69 percent in 2003, once an expansion to the first plant had been completed.

The Equity Offering

Once the business plan was established, producers were asked to review it and decide
whether to take an equity position in the project. The cooperative planned to mail business disclosure documents to members in October 1997. These documents represented USWP’s official equity offering. The minimum required investment was set at $4,800 (the amount held in escrow on behalf of the member), which was comprised of 800 shares at $6 each. One equity share represented the right and obligation to annually deliver one bushel of spring wheat. With 3,200 members, the cooperative needed an average investment of $9,600 per member to achieve its targeted equity level of $31 million. If the existing members were not able to meet this level, the cooperative planned to sell shares to new members, but at a slightly higher share price. Over thirty informational meetings to promote the equity offering in the four states began at the end of October 1997 and continued throughout November. Both members and non-members were encouraged to attend. The offering’s closing date was scheduled for December 8, 1997.

In December 1997 USWP announced that the offering had raised approximately $25 million in equity from over 2,800 members. Although this amount was short of its $31 million target, it was still considered to be a successful outcome. In fact, USWP’s CEO indicated that the cooperative could have moved forward with an equity amount as low as $10 million. The successful equity drive was the result of a strategic planning process that had lasted for 21 months. With this amount of equity, the cooperative reported that it could build its first production plant without the use of debt. The estimated cost of building its first plant was $20 million. The remaining $5 million in equity would be used for working capital. The planned expansion for the plant, expected to occur within the first few years, was estimated to cost $6 million.

In January 1998 USWP continued with its implementation phase and focused on five key areas:

1. Hiring senior management. Positions such as vice president of operations, vice president of sales, and chief financial officer needed to be filled. By December 1997 the cooperative had contacted over 150 candidates for both the vice presidents of operations and sales positions.

2. Selecting the geographic market to enter first. USWP hoped that they could select the region by the end of January and choose a plant site shortly thereafter.

3. Continuing its discussions with customers and distributors about possible strategic alliances. Once a vice president of sales and a geographic market were selected, these talks would become more focused.

4. Establishing a toll-milling relationship with one or two milling companies.

5. The cooperative also began to work on the plant and equipment design for its first facility.

Location

Throughout the site selection process, USWP wanted to make sure that their decision was based on the objective of maximizing member returns rather than on economic development. They did not want to choose a location merely because it would provide jobs and benefits for the local community. The decision had to be made based on customer needs. They wanted to maximize their members’ returns, and in doing so they did not limit their location choice to the Dakotas, Minnesota, or Montana.

By September 1997, the cooperative had divided the United States into 11 different market segments and had examined 26 possible sites. By December, the cooperative had narrowed down the selection to three regions. In February 1998 USWP announced that it had selected the Southeast region of the U.S. for the location of its first facility. Among its reasons for choosing this region were a growing population and demand for bread products; competitive
transportation rates; and an insufficient level of frozen dough and par-baked manufacturing capacity. The cooperative believed that it was the largest U.S. market for in-store baked goods. The decision to locate a plant nearer to customers rather than to growers was primarily based on transportation costs; it was too expensive to ship finished products from the growing region to the Southeast customer market. USWP’s CEO indicated that it is six times more expensive to ship par-baked products than it is to ship flour. Shipping frozen dough is three times as expensive. A specific site for the facility had not yet been selected, but the cooperative did indicate that they hoped to have a 75,000 to 100,000 square foot plant operational by the spring of 1999. USWP also announced that the West Coast region would be the location of its second facility.

In August 1998, the cooperative decided to purchase a vacant plant located in McDonough, Georgia. The facility had been built in 1994 and was previously used to make Chinese-style noodles. It was located in an industrial park that had access to major railway and interstate routes that would allow for product distribution throughout the Southeast. The cooperative’s headquarters would be based in Fargo, but its sales and operations personnel would be relocated to the Southeast region. McDonough, located about 20 miles away from Atlanta, was a distribution center for several prominent companies, including Nestles Foods and Ford. The location was ideal for several reasons, including its proximity to a large potential customer base: approximately 23 percent of the U.S. population lives within a 500 mile radius of Atlanta. The cooperative’s board approved a $20 million capital and operating budget for 1999, which was to be used for the following purposes:

- $2.35 million for the purchase of land and buildings
- $3.15 million for retrofitting of the plant
- $11.7 million for plant equipment
- $3.11 million for miscellaneous systems and professional fees.

By purchasing an existing plant rather than constructing a new one, USWP indicated that it would achieve significant cost savings. It would also be able to start up a facility more quickly; the cooperative estimated that the facility would be operational in 1999. The plant was designed to have a capacity to produce approximately 60 million pounds of finished product per year, using 1.2 million bushels of wheat in the process. USWP used a five-year average price of $3.91 per bushel of spring wheat in its cost projections, and estimated that it could be profitable by fiscal 2000.

USWP decided to position itself as a co-manufacturer. Essentially, this means that it would be producing finished products for companies that had previously produced the product themselves or had other manufacturers do it for them. As its CEO describes it, companies that would otherwise be USWP’s competitors would now be its customers. Under such an arrangement, USWP would manufacture products to conform to its customers’ specifications, and the customers would then market and distribute the products themselves. By letting others handle the marketing and distribution steps, the cooperative hoped to focus its efforts on manufacturing, as well as grain origination and supply management leading up to the manufacturing stage. It planned to promote itself as the first nationwide co-manufacturer of par-baked products.

Personnel

Early in 1998, the cooperative’s members elected the first permanent board of directors. Of the nine directors, five were from North Dakota, two from Minnesota, and one each from Montana and South Dakota. In March 1998, USWP hired its vice president of operations, whose previous experience included heading the operations of a Pillsbury plant in Indiana. By the fall of 1998 USWP had other senior management personnel in place, including a plant
Operations

By June 1999, USWP’s 100,000 square foot Georgia-based plant was ready to begin operations. The plant includes three 22-foot tall baking towers that sit in the world's largest vertical oven. In January 2000, the cooperative was ready to load its first 26-car unit train of wheat in Valley City, North Dakota. The train was to load members’ grain from an AGP grain elevator and ship it to its four partner, a Cargill mill in Chattanooga, Tennessee. The AGP elevator was chosen because it is capable of computer-assisted segregation of wheat varieties. Once processed, the flour would then be trucked to the Georgia plant. In December 1999, the cooperative also announced the formation of an alliance with Rich Products Corp., an international food marketing company. As part of the alliance, dinner roles made by USWP will be sold in Perkins restaurants. USWP plans on opening its next plant on the West Coast, and hopes to have four facilities operating within the next five years. The cost of the second plant is estimated to be approximately $20 million. The cooperative plans to build its facilities near major customer bases.

USWP’s President and CEO, Gary Lee, has noted that the cooperative's two core competencies are its integrated supply chain management system and strategic alliances with customers and suppliers.

Lessons Learned

Although USWP has only recently begun operations, it is notable for three main reasons:

1. It was able to raise $15 million in member funds before it had chosen what line of business to pursue.
2. The cooperative decided to locate its manufacturing facility outside of its member region.
3. It was able to open its first facility without the use of debt.

According to USWP’s chairman Mike Warner, a cooperative needs to answer two primary questions in order to successfully begin operations. USWP was successful in becoming an operational business because it answered these two key questions for potential members:

Who am I doing business with?

The cooperative was able to convince potential members that they would be doing business with a trustworthy group of people. It had established a leadership group that was credible and well-reputed among growers.

Does the idea make sense?

In addition to a establishing a credible leadership group, the cooperative also needed to convince potential members that their ideas made sense. In this respect, it maintained open communication with spring wheat growers throughout the development process. They made it clear that their business plan would be driven by customer needs and that they needed to hire people with business expertise. From the outset the cooperative made it clear that they intended to hire a group of experts to do the necessary analyses and planning for the company, and that in order to do so a sufficient capital base needed to be established. In other words, they believed in the saying that “it takes money to make money” and let their potential members know that. Mike Warner has indicated that the business planning process cost $1 million. The cooperative's organizers also believed that a sufficient capital base was needed in order to begin operations at a critical mass in terms of size. If it started out small with the
The cooperative was also successful in helping growers to understand that they could not wait to invest until a plan was in place; rather, a plan would not materialize if they did not commit their capital up front. USWP underwent an expensive effort to ensure that its ideas were sound and that it could clearly communicate these ideas to spring wheat growers.

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Introduction

A cooperative represents a unique way of organizing a business. In the United States, there have historically been three basic categories of business structures: sole proprietorship, partnership, and corporation. Cooperatives are a type of corporation. Corporations other than cooperatives will be referred to here as general corporations. A newer type of business structure, the limited liability company (LLC), has also recently emerged in the United States (Frederick). When referring to all business structures other than a cooperative, the term investor-oriented firm (IOF) will be used. The term IOF will be used when referring to any business firm other than a cooperative.

Cooperatives are in no way restricted to the agriculture industry or to rural areas. They can be found in many different sectors of the economy, including credit and financial services, housing, utilities, health care, child care, and insurance. There are more than 40,000 cooperatives in the United States. These cooperatives provide products or services that serve one out of every four American citizens (Rapp).

Cooperatives, like other business entities, are formed out of economic motivation; there is an identified economic need or opportunity to be met. A cooperative allows a group of people to achieve economic goals. By combining their resources in a cooperative, a group of people can achieve objectives that they could not do if they acted alone. Once started, cooperatives compete with and are subject to the same marketplace demands as other businesses. There are differences among the basic categories of business structures, however, in areas such as legal requirements, governance, and tax treatment. These differences are examined later on.

What is a cooperative?

Although there is no universally accepted definition of a cooperative, it is generally described as a business that is organized, owned and democratically controlled by the people who use its products and services, and whose earnings are distributed on the basis of use rather than investment. The people who use and own the cooperative are referred to as members. A cooperative operates for the benefit of its members. A distinct feature of a cooperative organization is that the role of owner
and patron are closely connected. A patron refers to a person who uses the cooperative. A cooperative is distinct because there is a linkage between the ownership and the users of the business. A cooperative is also distinct because it distributes its earnings to members according to the level of business conducted with the company rather than the level of equity investment.

**Cooperative characteristics**

A cooperative has three general attributes that distinguish it from other types of business structures (Cobia; Frederick). They are:

- the user-benefits principle
- the user-owner principle
- the user-control principle.

As you can see, the emphasis in cooperatives is on the users of the business, who are also the investors. In IOFs, the emphasis is on the investors, who might never be users of the business. One of the key features of new generation cooperatives is to increase the emphasis on the role of users as investors of the business.

**The user-benefits principle:**

As mentioned, the cooperative operates for the benefit of its members. Members represent the people who use and own the cooperative. Earnings that the cooperative generates during the year are distributed to members according to the level of individual business that they conducted with the cooperative during that year. Earnings are therefore distributed according to the level of use rather than level of equity investment.

**The user-owner principle:**

The people who use the cooperative are its owners. Since they own the cooperative, the members are responsible for providing equity capital in order to finance the cooperative’s operations. Typically, members finance their cooperative in three different ways: by direct contribution of membership fees or purchase of equity stock, by allowing the cooperative to allocate some of the net income earned from member business to member equity accounts rather than distribute them in cash, and through assessments on some regular basis such as per unit of product sold or purchased. There are three main methods by which members finance their cooperative: direct investment, retained patronage refunds, and per unit capital retains. A member is usually required to make some sort of payment when he joins the cooperative. This direct investment might be the purchase of a membership share or some sort of common or preferred stock. A patronage refund occurs once the cooperative determines how much earnings it has generated during the past year. Once the earnings are calculated, they are distributed to members according to how much business that each one has done with the cooperative during the year. Members who have done business with the cooperative are called patrons. These distributed earnings are called patronage refunds. Usually, not all of the patronage refunds are distributed as cash. Some of the patronage refunds are retained in the cooperative and allocated to members’ equity accounts instead. Retained patronage refunds occur when the cooperative does not distribute all of the patronage refunds in cash. Per unit capital retains can be a financing option for cooperatives that market products that are produced by its members. In such a situation, the cooperative withholds a portion of sales proceeds due to its members.
The user-control principle:

Members, through their role as owners, control the cooperative. They exert their control through voting power. Members vote to elect a board of directors and may vote in other affairs of the cooperative, such as major proposed policy changes. Generally, control is based on a one member, one vote principle; each member has only one vote in the affairs of the cooperative, regardless of the level of business that he conducts with the cooperative or the level of equity that he has invested.

Other Cooperative Features:

Limited Return on Equity Capital

In order to ensure that a cooperative allocates its earnings to members according to the amount of business that they transacted with the cooperative during the year rather than level of equity invested, federal and state statutes limit the level of dividends that can be paid on capital. Most state agricultural cooperative laws limit dividends paid on capital to a maximum of 8 percent (Vogelsang et al). Limiting the return on equity helps cooperatives to focus on meeting the members’ needs in their role as patrons of the cooperative.

Reasons for Formation

Although there can also be societal reasons for forming a cooperative, cooperatives are started for various economic reasons. For instance, the following reasons have given as to why cooperatives are organized:

- Improve bargaining and market power. For instance, many agricultural cooperatives were formed because farmers felt they were being taken advantage of by merchants and railroad companies. Because the size of their individual operations was small and there were so many of them, farmers did not have a lot of bargaining power when they negotiated as individuals. By joining together in a cooperative, farmers could increase their market power when dealing with other parties (Torgerson).
- Reduce costs. For instance, agricultural supply cooperatives can help to reduce costs of production inputs by buying in large volumes, thus taking advantage of volume discounts.
- Obtain products and services that are otherwise unavailable. The U.S. rural electric cooperative system is a classic example. In the 1930s, only one out of ten farms had electrical power, mainly because existing companies did not want to provide electricity to rural areas. Due to the low population density and wide geographical areas, existing companies could not profitably provide power to rural areas at reasonable rates (Cobia). Cooperatives were formed by rural residents to provide at-cost electric service. Today, rural electric cooperatives operate approximately half of the electrical lines in the U.S. (Frederick; NRECA).
- Expand new and existing market opportunities. For instance, many new generation cooperatives are formed to seek out and service emerging niche markets, such as the demand for bison meat.
- Improve product or service quality.
- Increase income.

Business Structures
In the United States, there have historically been three basic types of business structures used to organize a business: sole proprietorship, partnership, and corporation. A newer type of business structure known as the limited liability company (LLC) has also recently been introduced. The type of business structure used to organize a business is based on many factors, including the amount of capital required to finance the business, the number of owners involved, and taxation issues. Legal and accounting professionals are usually consulted to help choose the appropriate structure. The different business structures are only briefly described here.

**Sole Proprietorship**

A proprietorship is a business that is owned and controlled by one person. This is the oldest and most common form of business structure in use. Typical examples of businesses that are operated as proprietorships include farms and small businesses such as restaurants and flower shops. This type of business structure is used more dominantly in farming than in any other sector of the U.S. economy (Ingalsbe). As the sole owner of the business, the proprietor is responsible for providing equity capital and making the key managerial and strategic decisions involved in running the business. He is responsible for all debts and losses that the business might incur; in other words, the owner bears unlimited liability for the debts and losses of the business. In return for bearing the risk of loss and providing the equity capital, the owner is entitled to any profits that the business generates. Profits are taxed once, as part of the owner’s income at the applicable personal tax rate.

**Partnership**

A partnership is a business that is owned and controlled by two or more individuals. Typical examples of businesses that are operated as partnerships include professional law and accounting firms. Some farms are also operated as partnerships, most commonly between a parent and child. The rights and responsibilities of each partner are usually described in some sort of partnership agreement. This agreement will provide the details as to how business decisions will be made and how voting power is allocated among partners. It will also stipulate how earnings are to be allocated among partners. Note, however, that a partnership can be found to legally exist even without a written agreement.

As owners, the partners are responsible for providing equity capital to the business. There can sometimes be two types of partners: general and limited. Limited partners provide equity capital to the business in exchange for the opportunity to share part of the earnings that the partnership may generate. Limited partners are not permitted to be involved in managing the business, however, and in return for this passive involvement they are permitted limited personal liability in the debts and losses that the partnership may incur. General partners provide equity capital and participate in the management decisions that the cooperative undertakes. Each general partner is personally liable for the debts and losses of the partnership. Profits of the partnership are taxed once, as part of the partners’ incomes at the applicable personal tax rates.

**General Corporation**

A cooperative is a type of corporation. For our purposes, corporations other than cooperatives are referred to here as general corporations. A general corporation is a legal entity that operates like an artificial person; it has the right to own property, enter into contracts, buy and sell products and services, borrow money, and be held liable for debts and other damages. Corporations account for most of the business activity conducted in the U.S. (Cobia). They range in size from small businesses
owned by one person to large multinational organizations owned by thousands of people. Equity capital is raised by selling shares to investors. Ownership of a general corporation occurs by purchasing shares of the corporation’s stock. Owners are known as shareholders. The amount of votes that each shareholder receives is tied to the number and class of stock that he or she owns. In contrast to a sole proprietor or general partner, shareholders of a general corporation have limited liability for any losses or debts that the business incurs; they are only liable to the extent of the equity amount they have invested in the business. In return for providing equity to the corporation, shareholders are entitled to receive any dividends that the corporation may distribute. The amount of dividends each shareholder receives is based on the number and class of shares that he or she owns. Profits of a general corporation are taxed twice, once at the corporate level at the applicable corporate tax rate, and again at the shareholder level when profits are distributed as dividends, at the applicable personal tax rate.

**Limited Liability Company**

A limited liability company (LLC) is a newer type of business structure used in the U.S. that combines features of the other structures. In particular, the LLC combines the single tax treatment of a partnership with the limited liability for owners found in a corporation. Similar to a cooperative, the owners of an LLC are referred to as members. The rights and responsibilities of the members are described in an operating agreement. This agreement will provide the details as to how business decisions will be made and how voting power is allocated among members. The LLC’s members are usually the ones who provide equity capital to the business. The operating agreement stipulates how earnings are to be allocated among members. In an LLC, earnings (or losses) are usually allocated according to the member’s level of equity investment. Similar to the owners of a corporation, liability of the LLC’s members is usually limited to their level of equity investment in the business. Similar to the partners of a partnership, the earnings of an LLC are taxed once, at the member (owner) level. The LLC does have the option, however, to elect to be taxed as a general business corporation (Frederick).

**Cooperative**

As mentioned, a cooperative is a particular type of corporation. Cooperative members, like shareholders of a general corporation, have limited liability for the losses and debts of the business. Their liability is limited to the amount of equity the member has invested in the cooperative. The primary difference between a cooperative and the other types of business structures described here relate to ownership and the distribution of earnings. The owners of a cooperative are the people who use its products or services in some capacity: they are the patrons of the business. In a sole proprietorship, partnership, and general corporation, the owners might never be patrons of the business. For instance, a person might own shares in a general corporation such as Archer Daniels Midland, and thus be an owner of the company. That same person, however, might never conduct any business with ADM. In contrast, a person might be a member (and therefore an owner) of a cooperative such as Cenex Harvest States. That same person will use the services provided by the company. For instance, he may market his grain through the cooperative. Thus, a cooperative is distinct because there is a linkage between the ownership and the users of the business. A cooperative is also distinct because it distributes its earnings to members according to the level of business conducted with the company rather than the level of equity investment.

References

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History

Cooperative efforts have occurred throughout history. Since early man cooperated with others to help kill large animals for survival, people have been cooperating to achieve objectives that they could not reach if they acted individually. Cooperation has occurred throughout the world. Ancient records show that Babylonians practiced cooperative farming and that the Chinese developed savings and loan associations similar to those in use today. In North America, clearing land in preparation for the planting of crops, threshing bees, and barn raisings all required cooperative efforts. In the United States, the first formal cooperative business is assumed to have been established in 1752, almost a quarter-century before the Declaration of Independence was signed. This cooperative, a mutual insurance company called the Philadelphia Contributionship for the Insurance of Houses from Loss by Fire, was organized by Benjamin Franklin and others, and it is still in operation today (Cobia).

The cooperative as a modern business structure originated in 19th century Britain. The Industrial Revolution had a profound effect on the way business was organized and on the working conditions and economic situations of many people. In response to the depressed economic conditions brought forth by industrialization, some people began to form cooperative businesses to meet their needs. Among them was a group of 28 workers who were dissatisfied with the merchants in their community. They formed a consumer cooperative known as the Rochdale Society of Equitable Pioneers in 1844. They began by opening a cooperative store that sold items such as flour and sugar to members, and the Society quickly grew to include other enterprises. The founders also established a unique combination of written policies that governed the affairs of the cooperative. Among these rules were: democratic control of members, payment of limited interest on capital, and net margins distributed to members according to level of patronage. Based on its success, the Rochdale set of policies soon became a model for other cooperative endeavors, and became known as the general principles that make a cooperative unique from other business structures.

Agricultural Cooperatives

Agricultural cooperatives are typically classified according to the three major functions they perform: marketing, supply, and service. Many cooperatives combine all three types of functions in their operations.
Marketing cooperatives

Marketing cooperatives help to sell their members' farm products and maximize the return that they receive for these goods. Their operations can be quite diversified and complex. Some marketing cooperatives perform a limited number of functions, while others vertically integrate their operations so that they perform more functions that add value to their members' products as they move from the farm to the consumer. Some cooperatives even sell products in grocery stores under their own brand name; Land O' Lakes and Ocean Spray are two prominent examples. Marketing cooperatives can serve their members in many ways, including bargaining for better prices, storing and selling members' grain, and processing farm products into more consumer-ready goods. In the United States, agricultural cooperatives handle about 30 percent of farmers' total farm marketing volume (Mather et al.).

Supply cooperatives

Supply cooperatives (sometimes referred to as purchasing cooperatives) sell farm supplies to their members. Products include production supplies such as seed, fertilizer, petroleum, chemicals, and farm equipment. American farmers purchase about 28 percent of their supply needs through cooperatives (Mather et al.).

Service cooperatives

Service cooperatives provide various services to their members. For instance, cooperatives may offer services such as pesticide applications, seed cleaning, and artificial insemination. Service cooperatives also include organizations such as the Farm Credit System, a network of borrower-owned lending institutions that provide credit and other financial services to farmers, and rural electric cooperatives, which provide electricity to rural areas.

The first formal farmer cooperative to form in the United States occurred in 1810. However, agricultural cooperatives were not really perceived as a viable business organizational structure until after the Civil War (Cobia). Several farm organizations helped to promote cooperative development. The Grange, a farmer organization established to improve the economic and social position of the nation's farm population (National Grange), began to engage in cooperative marketing and purchasing. In 1875 it adopted the Rochdale system in carrying out its cooperative activities. Other farm organizations, including the Farmers Alliance and the Farmers Educational and Cooperative Union of America (known as the National Farmers Union), also began to promote cooperative development (Cobia). Farmers not affiliated with any farm organization also began to establish cooperatives. By 1900, at least 1,223 cooperatives were active in the United States (Mather et al.).

By the early 1900s the United States government began to pass laws that provided a favorable environment for cooperative development. A commission established in 1908 by President Roosevelt noted that the country lacked adequate credit for the agriculture sector, and their findings helped lead to the passing of the Federal Farm Loan Act in 1916, legislation that led to the creation of the Farm Credit System. The Capper-Volstead Act of 1922 was crucial for agricultural marketing cooperatives, as it provided limited antitrust immunity for farmers and ranchers who join together in cooperative marketing associations.

Government encouragement for agricultural cooperatives was highest during the 1920s and 1930s. Most state legislatures established agricultural cooperative acts during this time. America's agricultural sector went through a difficult period as prices collapsed after World War I ended. As part of the response to the adverse economic conditions, Presidents Harding, Coolidge, and Hoover all strongly endorsed the use of agricultural
The Agricultural Marketing Act of 1929, which included the establishment of a fund for cooperative loans, also helped to strengthen the cooperative movement (Cobia).

According to the United States Department of Agriculture (USDA), the largest number of agricultural cooperatives occurred during 1929-30. At that time, the USDA recorded 12,000 farmer cooperatives (Mather et al.). Although the number of agricultural cooperatives has been decreasing since then, total business volume has been rising. In its 1997 survey, the USDA reported that 3,791 farmer cooperatives generated a net business volume of $106 billion, equal to the record high set in the previous year. The net income was near the record high of $2.36 billion reported in 1995 (Richardson et al.). The number of farmer cooperatives has decreased through various activities including dissolution, mergers or consolidations, and acquisitions as cooperatives, like other businesses, adjust to a changing economic environment (Mather et al.).

References

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Lessons for Manitoba: Conclusions and Recommendations

Note: These conclusions and recommendations are also listed at the end of the Executive Summary.

Conclusions

1. New Generation Cooperatives are an important new development tool for rural economies. In future years, it will be shown that they were not an isolated phenomenon or oddity peculiar to North Dakota or Minnesota. The models developed in these states are spreading to other regions and countries, including Canada.

2. The NGC model is an outgrowth of the traditional agricultural business cooperative. Forces external to cooperatives (such as the industrialization of agriculture and globalization), and forces internal to cooperatives (free rider, horizon, control, portfolio, and influence problems) present significant challenges to the survival and success of traditional cooperatives. Traditional cooperatives are striving to meet these challenges in different ways. For new cooperatives, the NGC model deals with many of these same challenges.

3. One of the big challenges is the industrialization of agriculture. The NGC is often well suited to deal with this challenge. The advantages are perhaps greatest in single commodity niche markets where there is scarce investor-owned firm involvement or interest. The NGC provides producers with an opportunity to create a market for their product and participate in the supply chain for that product beyond the farm (e.g., bison, sugar beets).

4. A potential competitive advantage of the NGC over other firms is the tied integration of processing with the business of the farm. The farmer owner develops a greater knowledge of processing and of the demands of the consumer. This knowledge, when applied back at the farm level, results in improvements in product quality as well as farmer/processor relations.

5. There are several factors that explain the high level of interest in NGCs in North Dakota and Minnesota. First, the NGC may provide a market for the producer which would not otherwise exist (e.g., American Crystal Sugar Company). Second, the NGC may represent an attempt to increase local competition for the product and tighten the “basis”. Third, the NGC may simply be an investment vehicle for the farmer, allowing the farmer to participate in the investment of his commodity beyond the farm. The distinction between the farmer-as-owner and the farmer-as-venture capitalist in many cases may not be great. Finally, the NGC may be seen as a vehicle for rural development and community renewal.

6. The rural development motive is a two-edged sword. For the farmer/entrepreneur the compelling reason behind all investment decisions must be the business case. In the competitive world of agriculture, developing business solely for social reasons will likely fail. However, the rural development and community renewal motive is a powerful reason for both government and the public to participate. They do this by developing a vision and direction for the province/state, and by facilitating development of new cooperatives through cooperative development support and start-up cost support.

7. In some cases, the NGC will be the most appropriate legal form of organization for
the business. In other cases, different forms of partnership, corporation or traditional cooperative will be more appropriate.

8. The NGC is an important tool for rural development but it is not a "silver bullet". Sound business opportunities must exist and there will be failures.

9. It is important that legislation be accommodating to NGC formation. For example, legislation that requires costly and unnecessary steps regarding securities and disclosure can be a major disincentive to business development.

10. When choosing the legal form of the proposed enterprise, taxation may be an important factor. In the United States, cooperatives are accorded single tax treatment status for qualified profits allocated to members. In other words, the member pays taxes on these allocations while the cooperative can treat these allocations as eligible deductions. Similar status has evolved in the United States for certain types of private investor-owned firms, particularly the limited liability company.

11. The US experience regarding NGCs was driven by the coincidence of several factors. Many of these factors are common to both Manitoba and North Dakota, such as the regions’ strong cooperative heritage, poor commodity prices, enterprising crop and livestock producers, and the effects of industrialization and globalization. However, there were several key factors unique to North Dakota. If these factors can be ranked in importance, the first might be the existence of the sugar beet industry’s experience with the “American Crystal Sugar” model and its related impacts (success, knowledge, and experience). The second was the existence of cooperative development units that were allowed to operate with a high degree of freedom (in particular, the NDAREC’s cooperative development specialists). The third factor was the support and financial assistance provided by APUC, the St. Paul Bank for Cooperatives, the federal government, and the state-owned Bank of North Dakota. Manitoba’s success will be determined in part by our ability to develop similar approaches and competencies.

12. Although there are many critical success factors, three are highlighted. The most important is the soundness of the business opportunity. The NGC form of business is no substitute for good business sense. Second, timing of the fund raising can be critical. For example, Northern Plains Premium Beef seemed to be plagued by inopportune timing within the cattle sector. Many ventures in 1995/96 had opportune timing due to farm program payments and high grain prices. Third, timing of entry into the business can be critical. For example, the actions of Dakota Growers Pasta Company were advantageous in terms of industry timing.

As a closing comment, this study affirms the conclusion by many that there was a very exciting and distinct environment in North Dakota and Minnesota in the 1990s surrounding the formation of this new generation of cooperatives. This environment was highlighted by a quantum shift in entrepreneurial culture beyond the farm gate. It was nurtured by government and key organizations. It was aided by the sugar beet experience, high farm income in the mid-nineties, and several early success stories. It was implemented by farmers willing to take risks with their time, their money, and their products. To quote Bill Patrie (in conversation): “What I like about New Generation Cooperatives is the direct involvement and commitment by producers with their dollars and their products.”

**Recommendations**

There are clearly some unique circumstances that propelled North Dakota to the forefront of NGC development. In particular, the state had potential NGC leaders and development assistance in place. These factors, when added to other more
commonly found factors, ignited the spark for the North Dakota experience. This combination of factors explains, in large part, why North Dakota was the innovator and not Manitoba, Nebraska or other states or provinces. However, when it comes to the adoption of new approaches it can often be as beneficial to be an adept follower as a successful innovator. Manitoba has already taken several steps to encourage the development of NGCs. The following points underline these efforts and outline additional initiatives to encourage NGC development.

1. NGC friendly legislation

The Cooperatives Act (Chapter C223) has recently been updated and changed in Manitoba. Some of these changes to the Act will be more accommodating to NGC formation than previously.

2. A long-term strategy

A consistent, high profile, long-term strategy toward value-added processing and the formation of NGCs is needed. In North Dakota, a direction developed with the Vision 2000 process and was reinforced with the “Growing North Dakota” initiatives. A dedicated process in Manitoba with the goal of defining an understandable, visible, long-term strategy regarding value-added cooperative development is necessary.

3. Coordinated provincial public sector efforts

A number of provincial departments currently play a role in NGC initiatives. The department of Industry, Trade and Mines has responsibility for cooperative development. NGCs are primarily agricultural and therefore Manitoba Agriculture and Food is involved. Because NGCs provide an additional tool for rural and community development, Intergovernmental Affairs is involved. Other departments, including the Registrar of Cooperatives within Consumer and Corporate Affairs, are consequently becoming interested and involved in NGC development. Other interested parties include the University of Manitoba, ARDI, Manitoba Rural Adaptation Council (MRAC), and the Manitoba Agricultural Credit Corporation. It is important that all of these efforts be centrally coordinated.

4. NGC start-up support

More support for the start-up of NGCs is needed. The early legal and consulting costs regarding formation, feasibility and funding are often modest in the broad scheme of things; however, it is precisely at this stage when funds are hardest to procure. In this area, the Manitoba Agricultural Credit Corporation is clearly a key player in the absence of institutions like the St. Paul Bank for Cooperatives and the Bank of North Dakota. The assistance provided in Manitoba by the Manitoba Rural Adaptation Council and provincial programs has been important in developments to date.

5. Manitoba Cooperative Business Development Centre

In North Dakota, the efforts of Bill Patrie and others through the North Dakota Association of Rural Electric and Telephone Cooperative’s economic development programs were central to the formation of many NGCs. As part of the province’s long-term strategy, a Centre should be developed in Manitoba to carry out these same functions. Such an approach requires that the Centre be funded and then given the independence to pursue NGC development without the constraints of government or the narrower focus of private consultants. Both the public and private sectors are important. However, such a Centre would complement these efforts while filling a void that neither can easily fill.