COOPERATIVES

• COOPERATIVE
  – Special type of business (usually corporate) owned and controlled by its member-patrons (i.e., customers) and operated for them on a nonprofit or cost basis

COOPERATIVES

• More than 40,000 COOPs in the U.S. (2004)
• More than 3,300 COOPs in U.S. agriculture (2004)

COOPERATIVES

• Contribution of COOPs to the U.S. economy (by revenues, 2004):
COOPERATIVES

• Largest U.S. COOPs (2004):

<table>
<thead>
<tr>
<th>RANK</th>
<th>COOP</th>
<th>REVENUE ($ billion)</th>
<th>INDUSTRY</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>CHS (MN)</td>
<td>11.1</td>
<td>Agriculture</td>
</tr>
<tr>
<td>2</td>
<td>Dairy Farmers of America (W)</td>
<td>8.5</td>
<td>Agriculture</td>
</tr>
<tr>
<td>3</td>
<td>Land O'Lakes (MN)</td>
<td>7.3</td>
<td>Agriculture</td>
</tr>
<tr>
<td>4</td>
<td>Western Food (NE)</td>
<td>7.1</td>
<td>Grocery</td>
</tr>
<tr>
<td>5</td>
<td>TOPCO Associates (IL)</td>
<td>5.6</td>
<td>Grocery</td>
</tr>
<tr>
<td>6</td>
<td>Associated Wholesale Grocers (KS)</td>
<td>4.6</td>
<td>Grocery</td>
</tr>
<tr>
<td>7</td>
<td>ACE Hardware (IL)</td>
<td>3.3</td>
<td>Hardware &amp; Lumber</td>
</tr>
<tr>
<td>8</td>
<td>Unified Western Grocers (CA)</td>
<td>2.6</td>
<td>Grocery</td>
</tr>
<tr>
<td>9</td>
<td>Do-It-Best (W)</td>
<td>2.7</td>
<td>Hardware &amp; Lumber</td>
</tr>
<tr>
<td>10</td>
<td>Ag Processing (NE)</td>
<td>2.7</td>
<td>Agriculture</td>
</tr>
<tr>
<td>11</td>
<td>California Dairies (CA)</td>
<td>2.5</td>
<td>Agriculture</td>
</tr>
<tr>
<td>12</td>
<td>Group Health Cooperative (MN)</td>
<td>2.1</td>
<td>Healthcare</td>
</tr>
<tr>
<td>13</td>
<td>GROWMARK (IL)</td>
<td>2.1</td>
<td>Agriculture</td>
</tr>
<tr>
<td>14</td>
<td>Health Partners (MN)</td>
<td>2.1</td>
<td>Healthcare</td>
</tr>
<tr>
<td>15</td>
<td>True Value Corporation (IL)</td>
<td>2.0</td>
<td>Hardware &amp; Lumber</td>
</tr>
</tbody>
</table>

COOPERATIVES

Business volume of farm cooperatives by state (2001)

- Minnesota 10%
- Iowa 9%
- Wisconsin 9%
- Missouri 4%
- Illinois 3%
- Kansas 2%
- Nebraska 2%
- Other 46%

COOPERATIVES

• Cooperative “principles”:
  - User ownership
  - User control
  - User benefits (returns above costs returned to patrons)
COOPERATIVES

• Return or distribution of earnings:
  - To customers in proportion to amount of patronage done with COOP (i.e., return on USE) = PATRONAGE REFUNDS
  - To investors in proportion to amount invested in COOP stock (i.e., return on INVESTMENT) = DIVIDENDS (not to exceed 8% of capital per year)

COOPERATIVES

• Patronage Refund Example:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>COOP Sales</td>
<td>$200,000</td>
</tr>
<tr>
<td>COOP Expenses</td>
<td>$180,000</td>
</tr>
<tr>
<td>COOP Earnings</td>
<td>$ 20,000</td>
</tr>
<tr>
<td>Purchases by MEMBER A</td>
<td>$ 8,000</td>
</tr>
<tr>
<td>MEMBER A % of total for COOP</td>
<td>4%</td>
</tr>
<tr>
<td>Patronage Refund (4% x 20,000)</td>
<td>$ 800</td>
</tr>
</tbody>
</table>

COOPERATIVES

• Purposes of agricultural COOPs:
  - Enhance bargaining power
  - Do as a group what cannot be done alone
  - Allow farmers to move up and down the marketing channel
  - Improve market coordination
  - Increase efficiency
COOPERATIVES

• What COOPs cannot do:
  – Set prices if product is NOT differentiated
  – Set prices if product is differentiated but supply is NOT controlled
  – Eliminate functions performed by middlemen
  – Ignore needs of customer/member
    • Membership is voluntary

COOPERATIVES

• Capper-Volstead Act of 1922:
  1. It permits farmers to get together to collectively market their products which, in the absence of such an enabling provisions, could result in antitrust action against them
  2. It protects the general public against the possibility of undue price enhancement as a result of any monopoly position that a group of producers could legally achieve by getting together

COOPERATIVES

• Capper-Volstead Act of 1922:
  – Persons engaged in the production of agricultural products
    • farmers, planters, ranchmen, dairymen, nut or fruit growers
  – May act together in associations to collectively perform certain activities
    • processing, preparing for market, handling, and marketing in interstate and foreign commerce of such products
  – Provided
    • No member of the association is allowed more than one vote because of his membership capital, or the association does not pay dividends on membership capital in excess of 8% per year
    • The association does not deal in products of non-members in an amount greater in value than such as are handled by it for members
COOPERATIVES

• Capper-Volstead Act of 1922:
  – If an association monopolizes or restrains trade to the extent that it unduly enhances prices of agricultural products, then the Secretary of Agriculture may order the association to “...cease and desist from monopolization or restraint of trade.”

COOPERATIVES

• Types of COOPs by line of business:
  – Marketing
  – Purchasing
  – Processing
  – Service
  – Consumer coops

COOPERATIVES

Number of farm COOPs (2002)

- Marketing: 1889 (31%)
- Rural Electric Cooperatives: 684 (11%)
- Supply (Purchasing): 105 (18%)
- Services Related to Marketing and Supply: 397 (7%)
- Rural Credit Unions: 1201 (20%)
- Consumer coops: 380 (9%)
- Rural Credit Unions: 512 (9%)
**COOPERATIVES**

Number of members in farm COOPs (2002)

- Marketing
  - 1049000
  - 37%

- Supply (Purchasing)
  - 1637000
  - 59%

- Rural Credit Unions
  - 3655
  - 0%

- Rural Electric Cooperatives
  - 10976
  - 0%

- Services Related to Marketing and Supply
  - 187000
  - 4%

**MARKETING COOPS:**

- Goal
  - Get high price for patrons' output

- Perform marketing functions
  - Assembly, grading, packaging

**MARKETING COOPS:**

- Market share of farmer COOPs (2001)

- TOTAL
- Livestock
- Fruits/vegetables
- Soybean processing
- Grain/oilseeds
- Cotton
- Dairy
- Cranberries

- 0% 20% 40% 60% 80% 100%
COOPERATIVES

• PURCHASING COOPs:
  – Goal:
    • Save money on patrons’ input purchases
  – Perform various functions
    • Retailing, wholesaling, manufacturing

COOPERATIVES

• PURCHASING COOPs:

![Market share of farmer COOPs (2001)](chart)

- Petroleun
- Fertilizer
- Crop protectants
- Feed
- Seed
- TOTAL

COOPERATIVES

• PROCESSING COOPs:
  – Goal:
    • Move downstream market channel to add more value for patrons’ output
  – Perform packing and/or processing functions
COOPERATIVES

• PROCESSING COOPs:

COOPERATIVES

• SERVICE COOPs:
  – Perform various services
    • Credit, insurance, electricity, telephone, irrigation, etc.
  – Organized in the 1930-40s to provide new/improved services to patrons
  – Examples:
    • COOPs provide electricity more than 25 million customers
    • Farm Credit System single largest lender in agriculture

COOPERATIVES

• CONSUMER COOPs:
  – Goal:
    • Provide cost-savings and/or new products/services to consumers
  – Examples:
    • Food, organic food, housing, healthcare, childcare
COOPERATIVES

• Types of COOPs by form of organization:
  – Independent local associations
  – Federated associations
  – Centralized associations
  – Mixed associations

COOPERATIVES

• Independent local COOPs:
  – Patrons or customers are direct members
  – Small and focused
  – Small size often limiting factor for success

COOPERATIVES

• Federated COOPs:
  – Patron member of local COOP, local COOP member of central organization
COOPERATIVES

• Federated COOPs:
  – COOP of local COOPs
  – Local COOP retains all power not expressly delegated to central organization
  – Achieves larger scale ("strength in numbers")

COOPERATIVES

• Centralized COOPs:
  – Patron direct member of central organization, central organization has local branches

COOPERATIVES

• Centralized COOPs:
  – Central organization retains all power not expressly delegated to local branch
  – Control at top by members, and direction given to locals
  – Achieves larger scale ("strength in numbers")
COOPERATIVES

• Mixed COOPs:
  – “Mixture” of federated and centralized COOP associations
  – Both individuals and other cooperatives are direct members

COOPERATIVES

• Mixed COOPs:

COOPERATIVES

• Main challenges faced by COOPs:
  – Financing
  – Management
  – Membership relations
  – Public relations
COOPERATIVES

• Financing challenges:
  – COOPs need as much capital as other businesses to perform similar activities
  – COOPs face more restrictions to add new capital than other businesses (e.g., by selling shares to the public)
    • Limitations in voting rights
    • Limitations in share transferability
    • Limitations in returns paid to capital

COOPERATIVES

• Management challenges:
  – Like other businesses, COOPs need excellent directors and managers to succeed
  – Unlike other businesses, COOP directors usually must be patron-members, so talent pool limited

COOPERATIVES

• Challenges from membership relations:
  – Members are both OWNERS and USERS
  – Most members in large COOPs not engaged
  – Problems with diverse customer base
    • Example:
      – Large- and small-scale farm operations at odds with 1-member 1-vote rule
COOPERATIVES

• Challenges from public relations:
  – Large size of many COOPs changed public perception about COOPs
  – COOPs have been prosecuted for violating antitrust laws

COOPERATIVES

• Trends in agricultural COOPs:
  – Declining number of COOPs

COOPERATIVES

• Declining number of agricultural COOPs

![Graph showing declining number of Farm COOPs from 1993 to 2002]
• Trends in agricultural COOPs:
  – Declining number of COOPs
  – Declining number of COOP members

• Declining number of agricultural COOP members

Members of Farm COOPs (million)

<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td></td>
<td>4.2</td>
<td>4.0</td>
<td>3.8</td>
<td>3.6</td>
<td>3.4</td>
<td>3.2</td>
<td>3.0</td>
<td>2.8</td>
<td>2.6</td>
<td>2.4</td>
</tr>
</tbody>
</table>

• Trends in agricultural COOPs:
  – Declining number of COOPs
  – Declining number of COOP members
  – Consolidation
    • From 1989 through 1997, USDA documented 777 COOP mergers, unifications, and acquisitions
COOPERATIVES

• Trends in agricultural COOPs:
  – Declining number of COOPs
  – Declining number of COOP members
  – Consolidation
  – New Generation COOPs (NGCs)

NEW GENERATION COOPERATIVES (NGC)

• Relatively new type of COOP used primarily in value-added processing of agricultural commodities
  – Permanent equity to fund NGC start-up and growth is financed through sale of “delivery rights”
    • Delivery rights represent a member’s right to deliver a specific amount of commodity to NGC
  – NGC members benefit in proportion to their use.

NEW GENERATION COOPERATIVES (NGC)

Key characteristics of NGCs:

1. “Defined” Membership
   • Number of members depends upon proposed capacity of NGC’s operations
NEW GENERATION COOPERATIVES (NGC)

Key characteristics of NGCs (cont.):

1. “Defined” Membership
2. Upfront Equity from Producers
   • Members must purchase a share of common stock or other membership interest to enable them to vote in all decisions set forth in bylaws

NEW GENERATION COOPERATIVES (NGC)

Key characteristics of NGCs:

1. “Defined” Membership
2. Upfront Equity from Producers
3. Delivery Right (and Obligation)
   • Members have both the right and the obligation to deliver a specific quantity of commodity each year

NEW GENERATION COOPERATIVES (NGC)

Key characteristics of NGCs:

1. “Defined” Membership
2. Upfront Equity from Producers
3. Delivery Right (and Obligation)
   • Members have both the right and the obligation to deliver a specific quantity of commodity each year
   • Delivery Rights are Transferable and May Fluctuate in Value
     – However, transfers subject to restrictions
NEW GENERATION COOPERATIVES (NGC)

• Iowa NGCs:
  o Law providing for them passed in 1996 as “Chapter 501”
    o At least 60% of equity and voting control must be held by farmers, not including landlords
    o At least 75% of equity and voting control must be held by farmers together with crop-share landlords and employees
    o Up to 25% of equity and control may be held by anybody else
    o Each member can only have one vote

NEW GENERATION COOPERATIVES (NGC)

• Iowa NGCs:
  o Law relaxing restrictions on non-patron equity capital passed in 2005 as “Chapter 501A”
    o Patrons must maintain at least 15% of COOP’s member voting rights
    o At least 50% of board of directors’ voting power elected by patron members
    o Patron members must maintain at least 15% of COOP’s financial rights

COOPERATIVES

• Iowa NGCs: Examples