Consolidation and Competition in Midwest Agriculture: Are These Game Changers?

Crop Pest Management Short Course

U of MN, MN Crop Production Retailers Association

Minneapolis, MN

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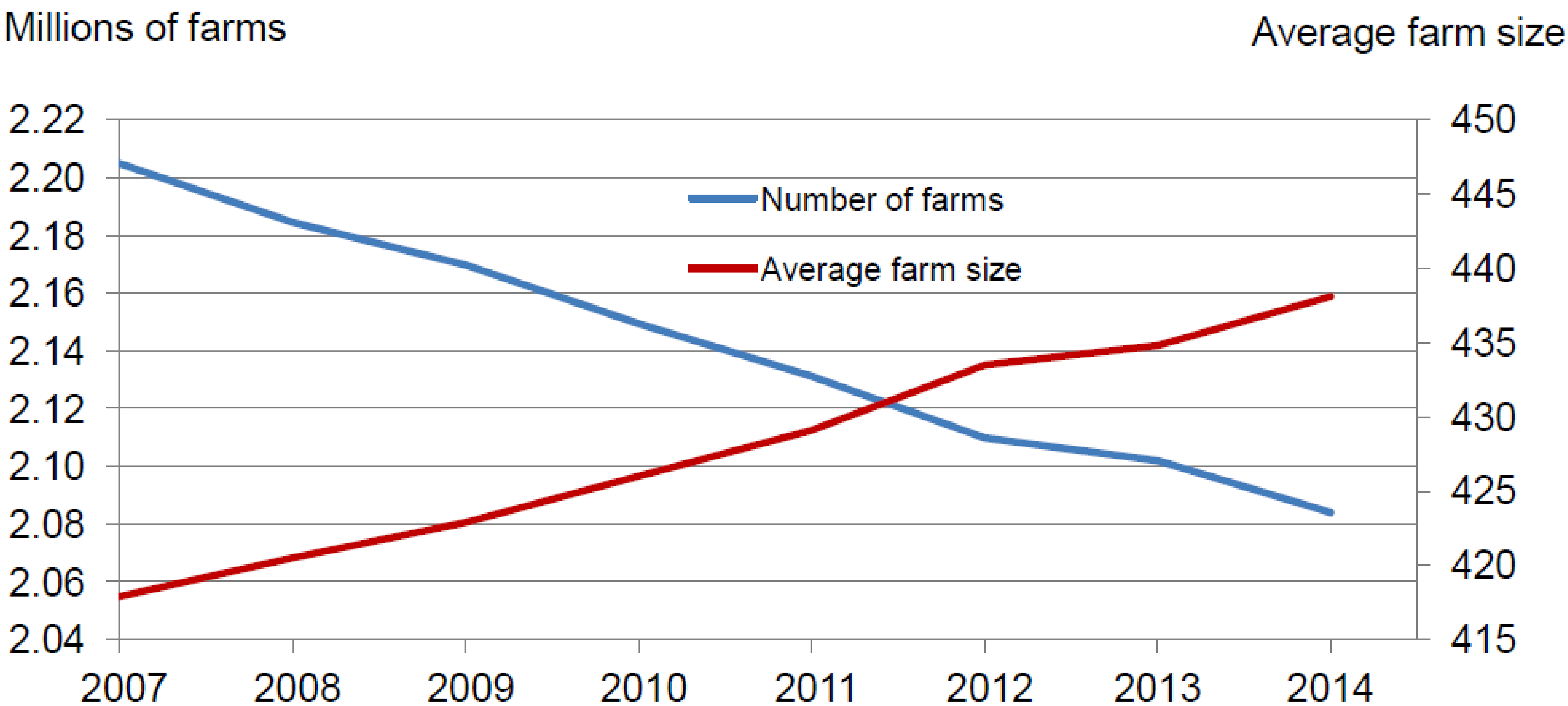
What We Observe

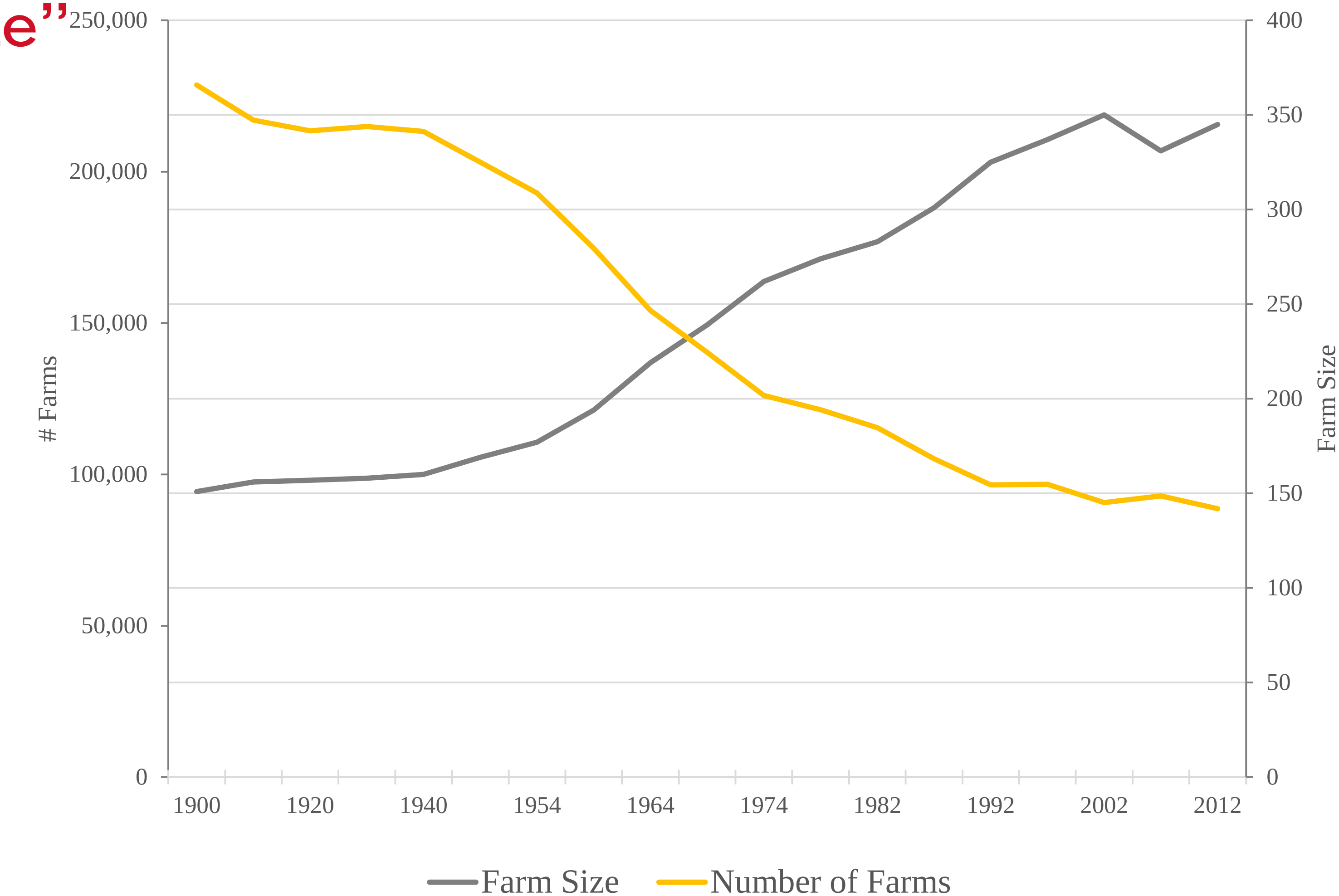
- Increased diversity of producers' operations (size, structure, needs)
- High profile mergers and buy-outs along the supply chain (evolution of SC)
- Consolidation of agricultural retailers (marketing and input supply)
- Human capital available and costs in flux

Number of Farms and Average Farm Size – United States: 2007-2014



Data Source: National Ag Statistics Service, USDA, 2017

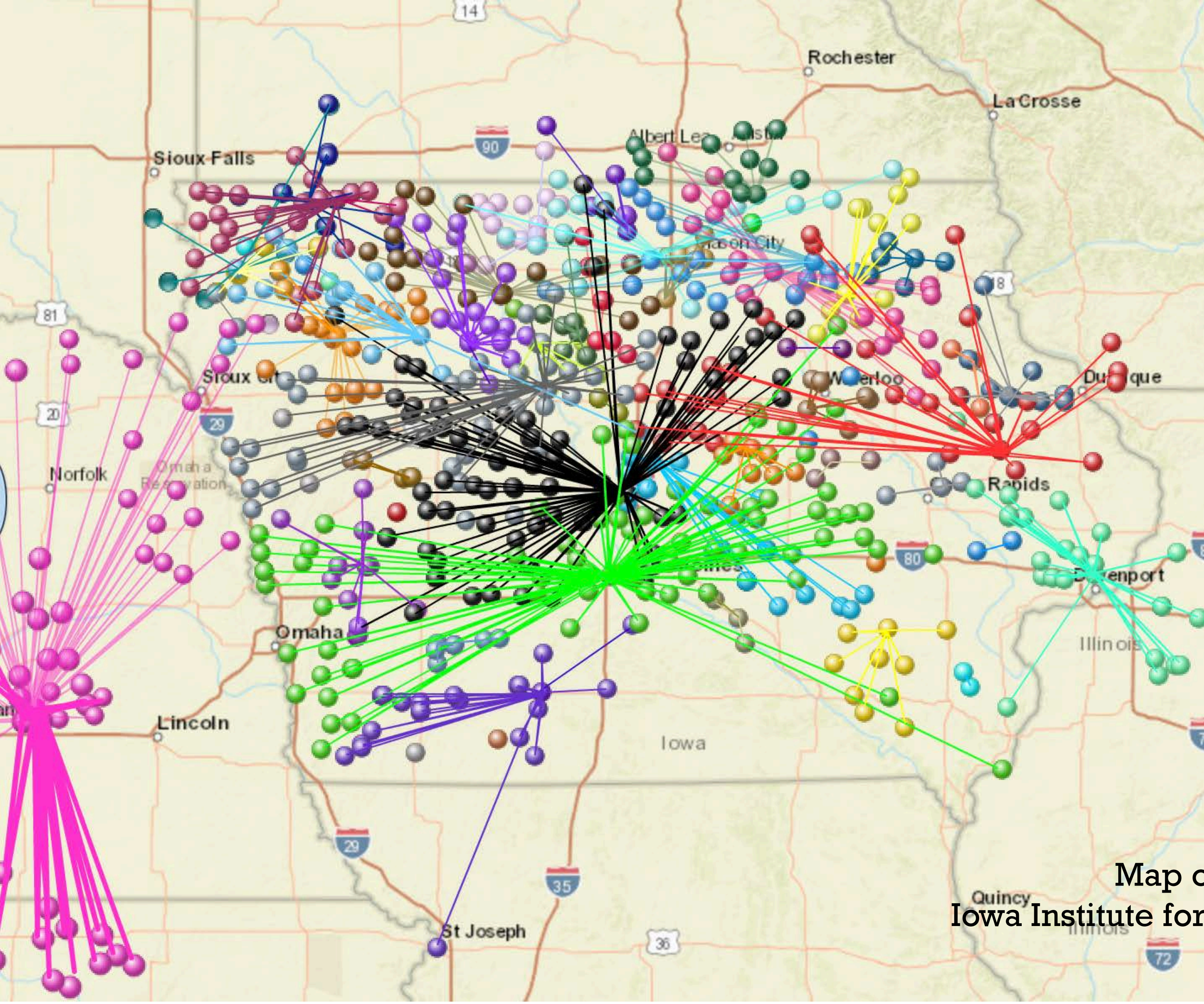
Farm Numbers and Size in Iowa – "Losing the Middle"



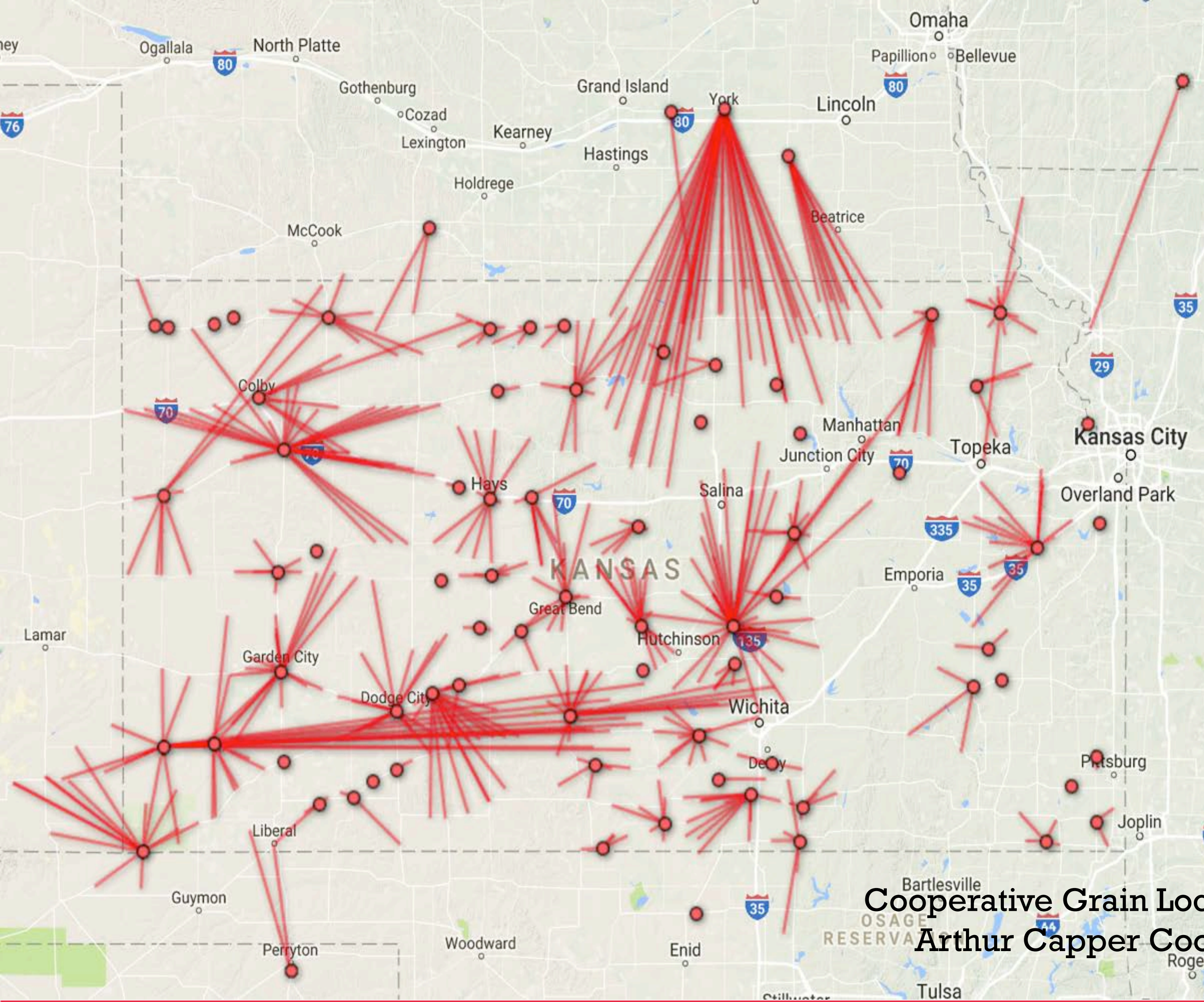
Data Source: National Ag Statistics Service, USDA

Wholesalers and Retail Partners Pursuing Strategic Horizontal Growth

- Bayer – Monsanto
- Dow – DuPont
- ChemChina – Syngenta
- Agrium – Potash
- John Deere – ?



Map of Iowa Co-ops
Iowa Institute for Cooperatives



Cooperative Grain Locations in Kansas
Arthur Capper Cooperative Center

Kansas

- 74 g&fs, approximate 588 branches
- Retiring managers a catalyst
- Co-ops bypassing merger vote through L.L.C. structures

Minnesota

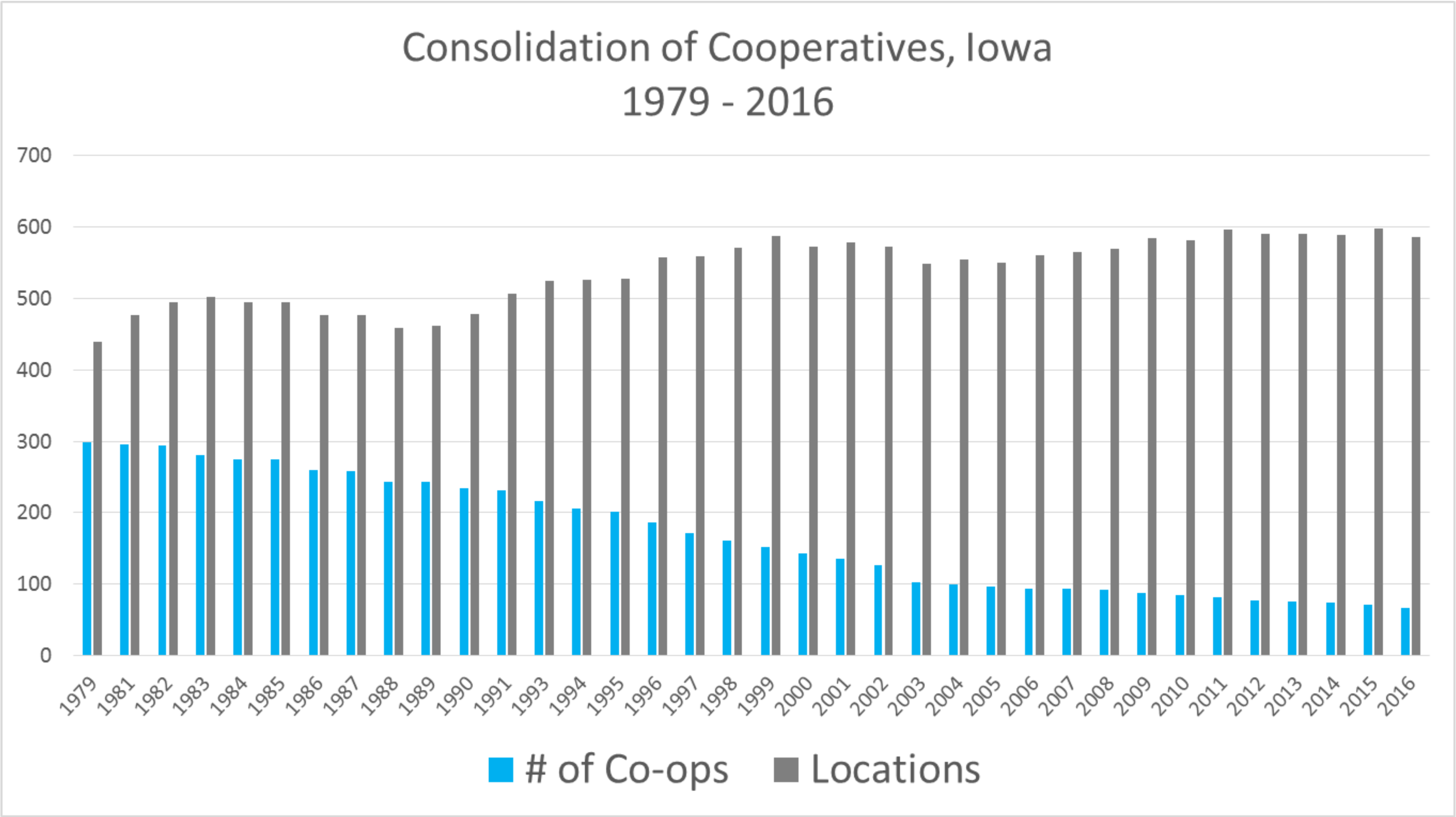
- Most g&fs are 1 – 3 locations
- Uptick in mergers but some voted down
- Farmers value choice of doing business with many retailers
- Managers see clear 'back office' and safety cost savings and talent acquisition by merging
- Energy co-ops: risk, and difficult to scale up to get cost efficiencies

Missouri

- Landscape dominated by MFA, Inc. (100, of which approx. 24 are independent)
- 20 – 25 independent local g&fs – most 1 location
- Very few 'super locals'
- Increased importance of non-member business to generate permanent equity

Oklahoma

- < 40 co-ops, merger is a big topic
- Financial stress (severe droughts, infrastructure issues)
- Cotton profitability driven by volume
- Grain alliances are major part of landscape (Equity Marketing Alliance merger with CoMark, L.L.C.)


Consolidation of Cooperatives, Iowa
1979 - 2016
700
600
500
400
300
200
100
0
1979
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
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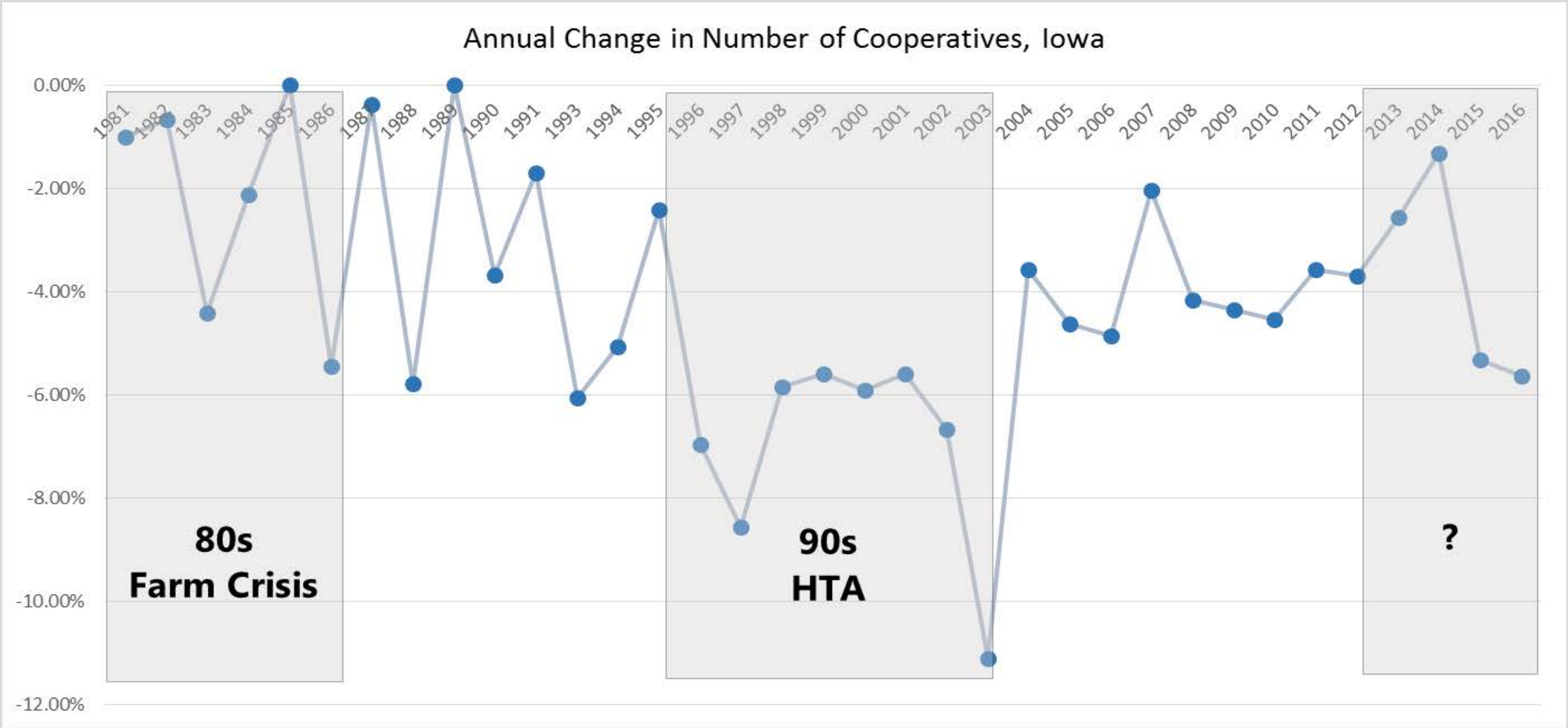
2015
2016
# of Co-ops
Locations

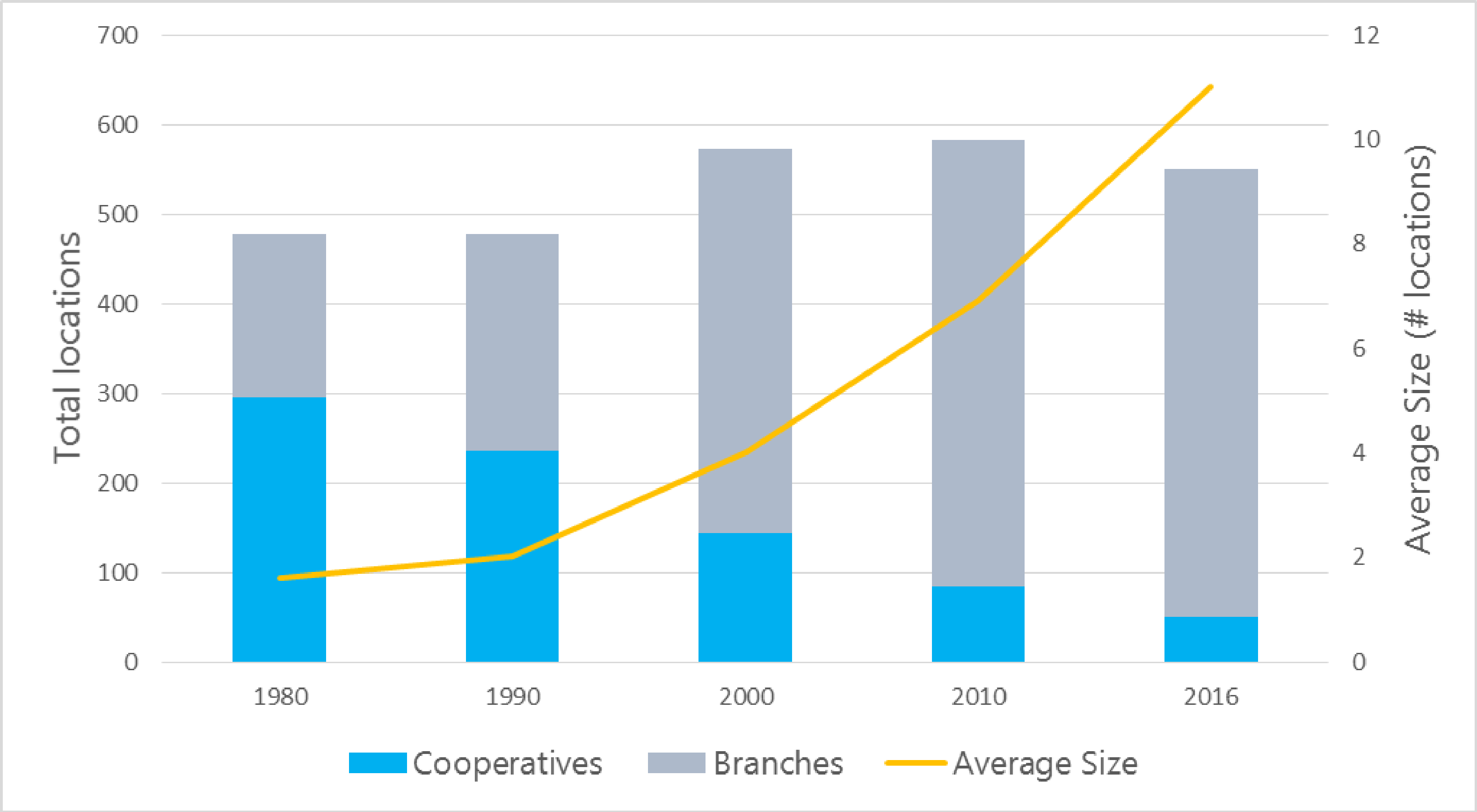


1980s: mirrored loss of farms during period

1990s: HTA forced restructuring

Current: steady rate through ethanol era, recent uptick driven by human capital needs and "efficiencies" versus financial challenges

Number of Co-ops in Iowa Cut in Half About Every 10 Years



Justifying Consolidation

- Enhanced cost efficiency in admin and operations (economies of size) – reduced redundancies
- Excess capacity
- More ‘output’ with fewer inputs (economies of scale)
- Access to strategic assets
- Access to talent – employees and managers
- Value creation in the eyes of producer-members

Squeeze or be squeezed!

Horizontal versus Vertical?

Horizontal

- Acquiring 'like' processes at the same level of the supply chain
- Ex: West Central + FC
- Why: size, reduce competition, economies of scale, gain access to new markets/customers, negotiation power with business partners

Vertical

- Acquiring processes/production at a different level of the supply chain
- Ex: Agrium + CPS
- Why: capture margins along supply chain (bring value in-house), reduce costs, control supply chain (transaction costs).

Why NOT merge?

- Managing a company's non-pecuniary value proposition easier for smaller companies
- Current financial strength with a solid core business
- Culture
- Able to innovate and be nimble by staying strategically small
- Governance

What we know

- It's not new, but it feels different
- The squeeze is on
- It's not going away
- It is not driven by the downturn, but that is making it harder
- Bigger is not *necessarily* better

The crux for co-ops

- "The co-op is just another big business."
- "It's not my co-op anymore."

The member-level frictions created through consolidation have significant implications. Yet, managers believe it may be required to compete for the younger farmers.

Consolidation – the act of it – is fundamentally putting at odds members' values and perceptions with leaderships' values and perceptions.

What co-ops need to figure out…

- At what point does a co-op cross that threshold from being "the farmers' co-op" to "just another big business"?
- How does heterogeneity of members impact the value proposition of the co-op and what can be done about it?
- How do you ensure that all members benefit from the joint provision of value in a perceived and real way?

What producers need to figure out

Regulators, DOJ, other countries will have a say in what happens with the mega mergers.

As producers, your best bet is to:

- Figure out how to do business with companies that protect your power in the marketplace, or…
- Figure out how to integrate into the value portions of your supply chain.

This is not new, it's just on a different scale, and we've forgotten (see rural retailer history, circa 1922).

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