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New Generation Co-operatives

Rebuilding Rural Economies

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Rebuilding Rural Economies

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New Generation Co-operatives

What is a New Generation Co-operative?

The phrase New Generation Co-operatives (NGC) is the term that has been applied to 50 or so co-operatives that have emerged in North Dakota and Minnesota in the last four to five years. These co-operatives are termed NGCs for at least three reasons:

- They represent the newest generation of co-operatives; earlier generations emerged in the 1920s and then again in the 1940s;

- Their major focus is value-added processing, representing a departure from the main objective of commodity marketing held by their predecessors; and

- Rather than acting as clearinghouses for product, an NGC is restricted to only accepting a predetermined amount of product from its members. In fact, a “two-way” contract exists between the members and the co-operative that requires the member to deliver a certain amount of product to the co-operative and requires the co-operative to take delivery of this product.

How Do NGCs Work?

Two policies distinguish new generation co-operatives from traditional co-operatives: delivery rights and restricted membership. The reason for the different membership and financial structure stems from the processing focus of the NGCs. In their feasibility study done prior to start-up, the proponents of the NGC have to make a decision regarding the capacity of the processing facility they will construct. Once the effecient level of capacity is decided, the amount of product members can deliver to the plant is essentially fixed.

To allocate the right of delivery among potential members and to raise capital for the construction of the plant, shares are sold in the co-operative. Each share entitles a member to deliver one unit of farm product (e.g., one bushel of durum) to the co-operative. The price of each share is determined by taking the total amount of capital the co-operative wishes to raise and dividing it by the number of units of farm product that can be absorbed by the processing facility.

NGC Case Study

Switching Gears to Increase Farmer Returns

In 1991, a group of irrigators from Central Minnesota were looking for alternative crops that offered a better return than corn and soybeans. The area is well suited to the production of corn and peas but these crops were not grown because there was no processing facility in the area. A feasibility study showed that access to a processing plant would indeed open up production alternatives for local irrigators. Three years later, 67 Central Minnesota growers pledged 9,000 acres of sweet corn and pea production and contributed $US 2 million in equity capital towards the construction of a $US 9 million vegetable processing plant. The establishment of the Northern Lights Vegetable Cooperative enables producers to diversify farm production and gain “a piece of the value-added action, too.”

NGC Case Study

Securing a Market Through Value Added Processing

The Dakota Growers Pasta Company is one example of the 50 New Generation Co-ops that are revitalizing rural North Dakota and Minnesota. In January, 1992, a group of North Dakota durum growers held an information meeting. Less than two years later, the Dakota Growers Pasta Company began production in Carrington, ND. In the initial stages of this process, rural and co-operative development specialists helped producers define the problem and explore solutions. A thorough study of potential business opportunities in the area indicated that pasta production was a feasible enterprise which would serve the interests of durum producers. By establishing the enterprise as a grower-owned, closed membership co-operative, producers would not only benefit from a guaranteed market and a set price for the primary product, but they would also receive a share of the earnings of the processing plant.

With a solid business plan in hand the original group of producers, with the assistance of rural development representatives, began approaching other producers to convince them of the benefits of this strategy. The drive to generate both interest and equity was an important and daunting task, as interested producers were asked to commit themselves as members of the proposed co-operative by purchasing a minimum of 1,500 shares at a cost of $3.85/share. This represented a minimum investment of $5,775, a large sum to cash strapped farmers. In return, members were guaranteed delivery rights of one bushel per share to the future plant.

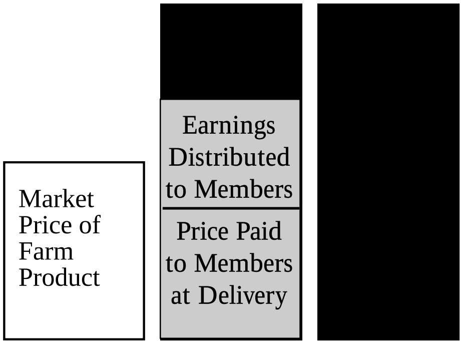
The equity drive was a success. A total of 1,040 durum producers invested $12 million in the project, providing 30% of the $40 million needed to build the pasta plant. These numbers translate into an average investment of $11,538 (2,997 shares) per member, illustrating the high level of commitment and enthusiasm for the project.

Dakota Growers Pasta Company began production in November, 1993. It now produces over 50 kinds of quality-assured pasta which is marketed both under its own label and more recently through industrial accounts. With production of 100 million pounds this year, the plant is well on its way to filling its 120 million pound capacity. Dakota Growers Pasta Co. has created 180 jobs in Carrington, population 2,267.

"What will carry us through the low times as farmer-business people will be diversified income from cooperative ventures. Value-added agriculture is the ultimate hedge against low prices."
Mike Warner, North Dakota Producer

For instance, in the case of the pasta plant in Carrington (see above), the co-operative wanted to raise $US 12 million as equity capital. The initial share price was determined at $US 3.85 per bushel and each share entitles the farmer to deliver a bushel of durum to the pasta plant. Farmers were given the opportunity to purchase shares at the initial price during the co-operative's equity drive. Currently, share prices reflect the returns members expect to receive from the co-operative and shares can be traded with the approval from the board of directors. There is no requirement that each member hold the same number of shares, although there is a lower and upper limit. Regardless of the number of shares purchased, the principle of one-member, one-vote still applies when electing a board of directors and when deciding on major co-operative policy issues.

Because members have financed the co-operative up-front with an equity infusion, almost all of the earnings generated by the co-operative are returned to the members at the end of the year. For example, in the pasta co-operative, members receive 60 percent of the current market price when they deliver their durum to the plant. At the end of the year, earnings are calculated by taking the total revenue generated from the sale of pasta and subtracting off the total expenses of the co-operative (see diagram). Allowance for a contingency fund is also made in determining the earnings to be distributed to members. The earnings are divided among members in proportion to the amount of durum they delivered. Future expansion of the co-operative will be financed in the same way as the co-operative was originally financed; that is, members will have to invest their money up-front through the purchase of delivery shares.



NGC – Enabling Producers to Capture More of the Food Dollar

Producers must fufill their contract obligations with their own product or purchase product elsewhere for delivery to the plant. In the event that a producer is unable or unwilling to meet their contract requirements, the co-operative purchases the required amount of commodity and charges the cost against the member's account. The member's dividends will reflect the charge.

NGC Principles

In Keeping with Tradition

The NGCs have some similarities with traditional co-operative structures:

- Democratic tradition is maintained through a policy of one member, one vote.
- Excess earnings are distributed among the members as dividends.
- The Board of Directors is elected from the membership by the membership.

Many of the NGCs also offer preferred shares to enable contributions from the community or other interested parties. Holders of preferred shares do not have voting rights and there is a limit on the amount of interest paid on these stocks (in North Dakota the limit is legislated at 8%). This policy lets communities support the project while keeping control in the hands of the producer members.

It is the responsibility of the board to set the co-operative's strategy, goals, and objectives, and to hire a manager. The manager, in turn, is responsible for conducting activities to achieve the goals and objectives of the co-operative, evaluating performance, and reporting to the board. The board and managment have a collective responsibility to report to the membership. The success of any co-operative is therefore directly related to the confidence the membership places in its elected representatives and management team and the ability to maintain continuous communication between all three parties.

The membership and financial structure of NGCs provides members with a higher degree of personal ownership and a greater degree of commitment to the organization than what is typically the case in more traditional co-operatives. This commitment plays a key role in allowing the co-operative to meet its objectives of establishing a profitable and efficient agribusiness that captures more of the food dollar and provides a market for agricultural commodities.

The Background for NGC Development

In the 1980s, North Dakota faced problems not unfamiliar to other agricultural based, prairie economies. Poor commodity prices and drought were causing financial pressure at the farm and rural community level, while the continuing centralization of rural services was reducing rural employment opportunities. Rural population was declining and incomes were falling.

In 1989, Frank and Deborah Popper wrote an essay "Buffalo Commons" which started a chain reaction that has been described as "The Renaissance of Rural North Dakota," "The Co-operative Revival for Rural America," or simply "Co-op Fever." The Poppers viewed North

Dakota as unsuitable for the population that lived there and advocated relocating people out of the area and returning the land to its original use, a buffalo range. This was like rubbing salt in the wounds of rural North Dakota. Rather than giving up, the people of rural North Dakota asked “What can we do to stop this spiral of decline?”

Out of these discussions arose a rural development strategy “Growing North Dakota,” a comprehensive package of programs, funds and initiatives designed to stimulate economic activity in the state. Partners in the program, including government, rural utility co-operatives, and financial institutions, focused on achieving the objectives of:

- reducing the rate of out-migration,
- increasing the population,
- doubling the state’s manufacturing jobs,
- increasing the average per capita income of rural residents to the national average, and
- diversifying agriculture and stopping the decline in farm numbers.

One of the tools in North Dakota’s development kit is co-operative enterprise development in the form of NGCs.

People in the state believe that "Growing North Dakota” is behind the “Rural Renaissance” that is occuring. From 1990 to 1994, per capita disposable income rose 11 percent, the population increased by 4,000, and manufacturing jobs increased by 3,500.

The Process

The success and proliferation of New Generation Co-operatives in North Dakota and Minnesota raises the question as to whether NGC formation follows a definable process. Although these co-operatives provide excellent examples and inspiration, there is not one recipe for success. There are several factors that are considered critical to a successful venture and the process itself varies with each situation. Flexibility to deal with diverse groups, commodities and communities is crucial. The process outlined below should be used as a guideline and not a rule book. Each situation will require a variation in steps and the process is often circular rather than linear.

NGC Case Study

Dakota Dairy Specialties Cooperative

When members of the Hebron Creamery Cooperative grew dissatisfied with their treatment by the larger dairies, they called in a facilitator from the Center for Cooperative Developement in Mandan, ND, to advise them of their alternatives. The decision to dismantle the existing cooperative and form Dakota Dairy Specialties Cooperative was the result of a long and at times, difficult process. The facilitator was present at every meeting, helping the group to define the problem, explore the alternatives, resolve conflict, encourage the leadership and involvement of the membership, and to ease the transition from the old structure to the new. The facilitator continues to be available to the group to assist in the resolution of problems that arise.

The process begins with a producer group realizing they face a common problem or a perceived opportunity. The group may proceed through the next stage on their own or enlist the help of a development agent or coordinator. If a coordinator's help is enlisted, this person works with the group to define the problem, assess resources, explore options, resolve conflict and enhance cohesion. The presence of this outside agent can provide the group with linkages to resources and information, both of which are useful in the achievement of their goals. In the case of the Dakota Dairy Specialties Cooperative (see box), representatives of the existing cooperative requested the assistance of a facilitator specializing in co-operative development.

Once the group has a clear understanding of the situation and have determined that they will be able to work together, they undertake a feasibility study. A well done, comprehensive feasibility study is one of the key elements of success. Those with knowledge of the industry, the resources and the market explore a range of possibilities and present several options to the producer group. The producers then have the information to help them make a sound decision on whether to proceed with the venture, and how best to go about it.

NGC Principles

Advantages of an NGC

- Producers can react quickly to opportunities.
- People work collectively to respond to problems or opportunities.
- Creates wealth within the community, and local ownership keeps it there.
- Restricted membership provides stability for producers and efficiency for the plant.
- A diverse set of stakeholders insures the interests of the community are considered.
- Producers and processors are committed to the quality of the product.

If the group decides to proceed, a detailed business plan is developed for the co-operative. The business plan is critiqued and adjusted by financial institutions and industry experts until all are satisfied that the plan provides an appropriate direction for the venture. Because the objectives of NGCs are to create a viable business to increase employment and diversify the economy, a solid business plan is considered a crucial component of the process.

NGC Practice

The Importance of a Network of Support

- Creates the environment within which development can occur.
- Coordinates development efforts to avoid duplication.
- Provides a variety of resources and expertise to serve the varying information and service needs of producer groups.
- Creates an atmosphere of enthusiasm that is contagious.
- Acts as a network linking producers, resources, funding, change makers, government, and other co-operative projects.

Next is the critical step of conducting an equity drive. The producer group, rural development representatives, and others meet with producers to convince them of the advantages of becoming members and purchasing delivery right shares. This is a critical step – the venture will not proceed unless it has the support and commitment of enough members to generate a reasonable chance of success. The general rule of thumb is to collect 50% of start up capital through the sale of shares. (This can be lowered to 35% or 40% through risk reduction strategies such as feasibility studies, marketing contracts, turn-key cost estimates, quality management and others.) If the co-operative is unable to solicit this much support from producers, financial institutions are unlikely to view the venture as a reasonable risk and will be reluctant to lend further capital. As well, sufficient product must be committed to ensure the plant runs efficiently. Once enough members are committed to the co-operative, preferred shares can be offered to other community groups or institutions. Remaining capital requirements are raised through debt financing.

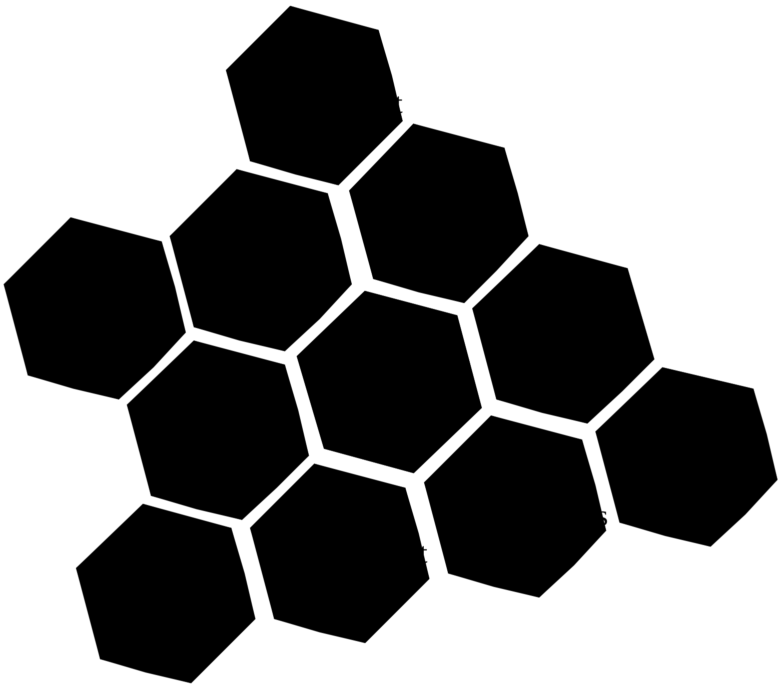
Elements Critical to the Growth of NGCs

The process at work in North Dakota started with the development of a comprehensive and focused rural development strategy, Growing North Dakota. This strategy established the infrastructure which provides the resources and the machinery critical to development. Representatives of various organizations in the state, created a network of support, information sharing, and enthusiasim. Government and quasi-government organizations do not drive the development, they support it. The impetus for development comes from producer groups and the government plays the role of advocate, encouraging a positive attitude and supporting projects by helping to remove some of the barriers. This environment creates ideal conditions for the growth of many different kinds of industry and enterprise development, including New Generation Co-operatives.

Within this environment, many factors contribute to building viable, sustainable enterprises. Faciltators and/or co-operative development specialists work as project coordinators and are an important link between producer groups and outside resources. They meet with producer groups to offer ideas and encouragement while guiding them through the process.

> *"A word of caution may be appropriate in the midst of all of the enthusiasm. Combining the cooperative form of business organization with the concept of adding value to farm products through further processing is NOT an automatic formula for success."*
>
> *Brent D Bostrom, Chair,*
> *Doherty, Rumble & Butler's*
> *Cooperative Law Department*

Motivated, determined producers are the most important element in the success of New Generation Co-operatives. Members must be willing to set aside egos and individualism to work on collective solutions. A core group of producers supportive of the New Generation Co-operative will spend many hours exploring options, arranging for feasibility studies and business plans, talking to other producers, and dealing with financiers as they lead the project through to completion. If this core group is present and highly motivated, they will draw the support and commitment of other producers and economic development agents. Without this group driving the project, the efforts of others to create development will be unsuccessful. The environment provided by the network and the catalyst provided by the coordinators make development possible. However, enthusiastic producers as project champions make development a reality.



Critical Elements in the Growth of New Generation Co-ops

NGC Case Study

A Solution to Low Commodity Prices

In the past, dairy producers in southwest North Dakota, sold their milk to the Hebron Creamery Cooperative, which in turn sold it to larger cooperatives who dictated the price paid to producers. Returns to southwestern dairy producers were lower than average, as shipping charges to finishing markets were levied. In an effort to gain control over their product and increase the price producers receive, dairy producers formed the Dakota Dairy Specialties Cooperative.

The results of an extensive feasibility study indicated that specialty cheese production was a profitable venture given the regions resources. Dakota Dairy Specialties has replaced the Hebron Creamery and will be building specialty cheese production facilities as an addition to the former creamery building. Plans to introduce premium ice cream to their product line are also underway.

Sixty dairy producers have joined the cooperative by purchasing shares which give them the right to deliver to the cooperative, providing a stable market for their milk. They will be paid according to the market price for milk and will share in the profits of the dairy. Board members see the new generation cooperative structure as a way to ensure member loyalty and a high quality product.

Those working to establish NGCs use practical tools: feasibility studies, business plans and equity drives. Creating viable enterprises which will continue to provide benefits to producers, employees and communities for the long term is the real objective of exploring NGCs as a development strategy. Therefore, it is crucial that a thorough feasibility study be conducted to determine the most appropriate response in any situation. A solid business plan is vital in the promotion and development of a business. When all the other factors are in place, the enthusiasm and motivation will fuel a successful equity drive. Producers and development agents committed to the success of the project and armed with a solid business plan based on a well done feasibility study will generate support and encourage the membership required for start up.

There is no fool-proof recipe or blueprint for the creation of NGCs or indeed for sustainable development. Therefore, the strategies and the people must be open and flexible. The process, the options and the decisions will be different in each situation. Nor are NGCs always the best alternative. NGCs will only be successful if they are chosen by producers as the preferred organizational form.

The number of successful NGCs in North Dakota and Minnesota creates the temptation to view this strategy as the answer to all the problems of rural areas. However, simply applying the NGC model will not turn bad ideas into good ideas, and will not automatically create viable businesses.

George Sinner is vice president of public and government relations for American Crystal Sugar Co. which is the oldest of the new generation co-operatives (21 years). Sinner reminds us that when considering co-operative business structures, we should emphasize the five Cs that are regarded as the building blocks of successful co-operatives.

> "Putting capital together to achieve a purchasing or marketing advantage. Allowing members to exercise control over the way they are treated in their contracts and markets. Communicating to make sure everyone in the organization understands what's happening. Establishing continuity with the past. Sustaining and improving the community."

NGC Practice

Potential Pitfalls for New Cooperatives

- Lack of a clearly identified mission
- Inadequate planning
- Failure to use advisors and consultants
- Lack of member leadership
- Lack of member commitment
- Inadequate management
- Failure to identify and minimize risks
- Overly optimistic assumptions
- Not enough money
- Inadequate communication

Brent D Bostrom, Chair,
Doherty, Rumble & Butler's
Cooperative Law Department

Can This Work in Saskatchewan?

A focused rural development strategy and NGC formation have had a positive impact on the economies of North Dakota and Minnesota. People have a new, positive attitude, resulting from the realization that they can take charge of their lives and influence the future of their communities. Can we expect a similar atmosphere on the Canadian prairies?

NGC Practice

The Role of the Facilitator

The appropriate facilitator or coordinator is a key element. The facilitator must:

- know enough about economic and business development to encourage the establishment of sustainable co-operative enterprises,
- have the organizational skills to bring diverse personalities together and create solidarity and cohesion,
- be enthusiastic about co-operative solutions to problems,
- allow the co-operative to form and make decisions on its own. The facilitator cannot do the job for the members.

Saskatchewan has been through a period of drought and low commodity prices. Farmers have diversified production into many unique commodities such as bison, elk, and borage. Vegetable and small fruit production far exceed traditional levels. Many of these commodities are reaching a critical stage of production. The profits to be made in the niche markets served by small scale production may soon be eroded by over-supply. As traditional structures and institutions change or are threatened by new regulations under GATT and NAFTA, producers are looking for other marketing options. The loss of the Crow benefit is also causing producers to look for new markets. Researchers have suggested the Saskatchewan economy could be stabilized through reduced reliance on the export of raw commodities. Establishing processing facilities in the province would create jobs and keep more of the food dollar in the local economy.

In this atmosphere of change and opportunity, it is important everyone have knowledge of a wide range of alternatives. Although they are not the appropriate response in all situations, NGCs have the potential to provide opportunities otherwise not possible. Knowledge of this alternative structure will help economic development workers, extension agents, and consultants make recommendations to groups seeking solutions to problems or mechanisms to capitalize on opportunities.

NGCs are one way of providing value-added activity in Saskatchewan. Choosing a producer-owned structure over a corporate structure gives producers access to a larger share of the earnings generated from such activity and also keeps these earnings circulating in the local economy. Local owners have a large stake in the success and longevity of the enterprise. NGCs are more likely to stay in the community and will be less tempted to move to take advantage of tax breaks or lower operating costs.

NGC Case Studies

1 — Taking Advantage of New Opportunities

Since 1993, the North American Bison Cooperative has operated a $1.6 million bison processing plant in New Rockford, North Dakota. In this town of 1,604, the 10 new jobs at the plant have made a significant difference. The Cooperative has 180 members located across the Midwest States and in Saskatchewan and Manitoba. Transportation costs are pooled among members so that those located at a distance to the plant are not penalized.

This year, the NGC will process 2,700 head. The product (boxed, fresh meat, individual servings and specialty products such as Jerky, Bison Bacon, and sausage) is marketed through the store front and shipped to East Coast restaurants and European markets. Demand for bison meat is growing steadily as a more health conscience population discovers the unique lean product. The co-op now slaughters and processes 20% of US bison and is confident it is well positioned to meet future market opportunities.

2 — Co-operation Among Co-operatives

In the late 1980s, four grain elevator co-ops near Renville, Minnesota merged to form the Cooperative Country Farmers Elevators. Also in the Renville area, corn producers formed an NGC, ValAdCo, to add value to their corn by feeding it to hogs. With a total investment of $US 17 million, ValAdCo houses 8,750 breeding sows. The large scale of this farrow-to-finish operation decreases the production costs per hog so that the co-op is able to pay dividends to its members. Other grain producers in the area formed Midwest Investors to transform grain into eggs. One million laying hens are housed in $US 9 million barns on the outskirts of Renville. The co-op markets eggs through a joint venture with a private egg company. Future plans include a plant to process eggs for use in the food industry, moving producers further up the food chain. To supply their own specialized feed mixes for hogs and chickens, ValAdCo and Midwest Investors joined with Coop Country Farmers Elevators to form United Mills. Coop Country assists the new co-op ventures and its farmer members by an expansion of services to provide accounting and administration services to the new coops and the introduction of a manure management program making manure part of the fertilizer mix the co-op sells to its members. The ability to utilize wastes through the manure management program helped the livestock operations meet the environmental standards of the pollution control board.

3 — Fishing for Information

The Dakota Aquaculture Cooperative and the North American Fish Farmers Cooperative is an information and marketing organization that serves 150 members across five states by providing research and demonstration facilities. The marketing arm develops markets and coordinates quality and supply. It supplies on-farm technical advice, fingerlings, feed and will soon offer tanker pick-up and delivery.

4 — Quality and Uniformity: The Virtual Feedlot

Central Dakota Cattle Association, Maddock, North Dakota, supervises and finances the backgrounding of cattle on the farms of its members. The co-op pays producers 95% of market value and supervises the feeding and care to produce uniform lots of cattle for sale to large feedlots for finishing. Pooling larger lots gives the group market power that individual producers cannot attain.

5 — Gaining Control

Strong competition from the well organized fruit co-operatives in Washington and Oregon put Minnesota apple producers at a disadvantage. To gain some market power, 30 apple growers are forming a cooperative. The cooperative will guarantee retailers a steady supply, uniform quality and packaging.

6 — Sweet Success

American Crystal Sugar Company has three plants in Minnesota and two in North Dakota. In operation since 1972, American Crystal produces 20 million hundred weight of sugar per year and pays out $290 million in beet payments. All sugar beets grown in the area are processed locally at American Crystal or other sugar beet co-operatives. American Crystal was the first of the NGCs and has served as a model for NGC formation and development.

"If people want this to work, nothing will stop them. They will overcome the barriers."
Bill Patrie, Rural Development Director, ND

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