

FORMING A VALUE ADDED COOPERATIVE

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First, I would like to thank you for this opportunity to visit with you about my favorite subject....Value Added Agriculture. It has become one of the hottest topics in agriculture, and from my perspective it should be. Hopefully, in some small way I can remove some of the confusion and add to the enthusiasm for what I think is the next historic step in the evolution of the greatest food production system in history. That is projecting production agriculture up into the food chain to process and market raw commodities in a highly efficient and seamless business system. The end result is greater value and quality for consumers and increased profits for the producer.

What These Cooperatives “Are” and “Are Not”

To get started today, I think we should make it perfectly clear what these cooperatives are and are not. They are not another version of the service cooperatives we are all so familiar with. Their job is to provide the farmer/rancher with goods and services like oil, fertilizer, fuel, feed, electricity and a market for our raw commodity. Their goal is to deliver these goods and services as cheaply and efficiently as possible. Traditionally, we don't look to them as any source of big cash income to our farms and ranches. They tend to retain most of their profits to make capital improvements and do their job better. So, they use the familiar formula of 80% retained earning and 20% cash.

The value added cooperative's main job is to make as big a profit as it can and send you the check in the mail, which you can then spend as you see fit. You will make a significant investment in shares of the company, and these shares represent a “RIGHT AND OBLIGATION” to deliver a certain number of units of production to the cooperative, such as bushels, tons, animals or pounds. There is a limited number of shares issued and these shares can be bought and sold between farmers. So, they can and do appreciate in value, depending upon the level of profits. These profits are paid out on a per share basis predominantly in cash with minimum amount retained. Therefore, they not only give you profits each year, but they also go on your farm and ranch balance sheet. In the successful value added cooperatives, the value of these shares can become one of the single greatest sources of growth in the asset base of the farmer/rancher who is involved.

Credibility Is the Most Precious Commodity for Success

Over the years I have been involved in several of these efforts. There have been some useful refinements, but they tend to progress in pretty much the same manner. There is a lot of specific and technical information about what exactly you have to do that are legal and financial requirements. However, they are just that.....requirements. There is also a natural progression of events or steps, if you will, but they are for another program. What I want to talk to you about are the “Real Reasons” you get a successful business started. They basically boil down to answering two fundamental and simple questions for the potential investor.

1. Does this make sense?
2. Who am I doing business with?

We could spend some time here talking about cooperative structure, what you do first, second and third, but all that can be retrieved quite easily from cooperative law firms and others. These are the two things that really make the venture go or not go. As simple as they sound, these questions contain a multitude of issues that must be resolved if you are to be successful. If you don't answer these questions to the satisfaction of yourself and other potential members; you aren't going anywhere. By answering these two questions properly you take ownership of the most precious commodity you will need for success and that is “Credibility”.

You must remember, you need these other investors to help get the business going. Its for the oldest reason in the world for people to come together and pool their resources. They can't do it themselves. In order to get their help, you must know your stuff. You must be able to answer all questions, and answer them right. If you ever look like you don't know what you are talking about or heaven forbid, you appear to be lying; you will lose all credibility in a single moment and then you are lost.

Credibility Question #1: Does This Make Sense?

At the inception of United Spring Wheat Processors, we were actually starting cooperative, where its only business was to find a business that would add value to spring wheat. Talk about making sense. When our potential member/investors first sat down at one of our meetings, we were asked many similar questions, and here are some of the answers.

- Q: What are you going to make?.....A: Something out of spring wheat.
Q: What will that be?.....A: We don't know.
Q: Where will you locate a plant?.....A: We don't know.
Q: How much money can we make?....A: We are not sure.
Q: How much to invest?.....A: We don't really know that either

Of course, I am being facetious. What we really said was this.

“We see other people in our region, like sugarbeet and durum growers, making good profits by adding value to those crops. We think it is time for spring wheat, the number one crop of our region, to do the same thing. To do that we have a plan we think will work, if you will help.”

So, we proceeded to tell potential investor/farmers in four states through over 100 meetings, what we thought “Made Sense”.

You Need Help

We said we didn't think we, as farmers, were competent to form a business to add value to spring wheat on our own. We planned to hire people to help us do that. When you think about it, the trick to starting any business does not hinge on what you know, but knowing what you don't know. Then proceeding to find the answers. Our intentions were to conduct a nation wide search to find a CEO. This person had to have experience in the spring wheat industry, and could help us form the business. He would know who we had to hire and what we had to do. We wanted him to be well known in the industry and particularly by the customers for our products made from spring wheat. Why did we want this? To add “Credibility” to our effort. In the end, we hired Mr. Gary Lee. He was the VP of Dry Milling Worldwide for Cargill, and also had been an internal strategic planner for Cargill.

Business Plan Must Be Customer Driven

We then told the potential investor/member that we believed this business must be designed from the end customer back to our fields. The customer was the best source of telling us what to build, where to build and how to run our business. Many value added cooperatives have been started as an economic development effort. The idea is to build a plant somewhere in your state or region and generate some jobs. If you do that without finding out where the customers are, who the competition is and how you can provide products efficiently and competitively; how can you hope to be successful. All too often the predominant marketing strategy in value added cooperatives is a “build it and they will come” market plan. This is one of the reasons many have failed.

The truth is the building of a plant is the easy part, and it is nice for the town that gets it. Often the location has something to do with where certain board members live. However, it only directly benefits about a 30 to 50 mile circle around the plant with any real impact. If you are not from that town, what do you get out of it? These business must be driven by customers needs, not the economic development department of you county or state, or it will fail. Another truth is that the best economic development in rural America is profitable farmers and ranchers with strong balance sheets using and improving the infrastructure that already exists.

So, we pledged to our potential members that the only criteria we had for building a plant or plants was that they would go where they had the best chance of making some money. In fact, our first plant is currently under construction in Macdonough, Georgia. It will be making frozen dough and frozen partially baked specialty and crusty breads. Keep in mind all our members are in North Dakota, Minnesota, South Dakota and Montana.

This Takes A Lot of Money

After explaining our plan, which essentially was starting a business to find and create a business; we told our potential members that we thought this would take a lot of money. Our best estimate was around \$1 million to hire the competent people and do the business planning. Improper capitalization is also a common trap for start up businesses.

One of the myths we enjoy in America is personified in the old Horatio Alger stories. You know the ones.....honest young man of pure heart and a dollar in his pocket is destined to become a millionaire through hard work and perseverance. In rural America, we particularly like that myth. We all want to believe we can start these business on the cheap. You know, start small, maybe even very small, and grow the business. We kind of believe we can go into a prospective customer and be taken seriously by saying something like this.

“Hello, we are a bunch of farmers, and we would like to make something out of our commodity. We in turn would like you to buy it. Now, we don’t know how to make it. We don’t have anybody hired who knows how to make it. We don’t have a plant to make it with. In fact, we don’t even have any money. Now, knowing all that, would you be interested in buying something from us?”

We then asked our potential members, who are pretty big buyers in their own right, if they would buy anything from a person like that. Every business has a critical mass in terms of size and production capability. If you are not that size to begin with, you will fail. This is something farmers actually instinctively know, but they still like the idea of those Henry Ford/ Horatio Alger....start small success stories.

We then told our potential members that in order to do the analysis we thought we needed to do to start the business, have credibility with the people we wanted to hire and credibility with our potential customers; we needed to get some serious money together. We then proposed what was essentially an installment pay plan to cooperative formation and membership.

First, we asked for what we called “Seed Money” of \$200 per potential member. We would use this money to start the analysis of our industry, and to conduct a search to hire our CEO. This would give each potential member the right to take membership in the cooperative, once we got it formed. At the same time we asked for the seed money, we told them we would be coming back for more money later. We called this money “Credibility Money”. This money would be put in an escrow account in their name, and they would then become members of the cooperative. We could not spend this money in

escrow, but we could use the interest income generated by these funds to continue the business planning and formation.

We felt, and the potential members agreed, that a significant show of money would give us credibility with a lot of people that were going to be very important to the success of the business. Customers: We wanted to be able to go into prospective customers, whose information and interest we very much needed, and say something like this instead.

“Hello, we are a group of farmers that intend to make a spring wheat based product. We would like you to consider being our customer. In order to prove that we are serious about this, we have hired our CEO, and you know him and his reputation. We have amassed \$15 million dollars to start the business, and we intend to collect significantly more than that from our members when our business plan is complete.”

We also needed credibility with the banking community. Not only to finance the business, but also to provide our members with financing to buy the stock. We needed credibility with the additional people we would hire to form and operate the business. They needed to see a well capitalized business for them to make a move to work for us. Finally, we needed some credibility with ourselves as members. We needed to know that each of us were committed enough to the idea of adding value to spring wheat that 2850 of us were willing to put up at least \$4,800 to start the business.

Finally, we told the membership that we would come back with a complete strategic business plan. They could then take a final look. If they liked the plan, they could convert the \$4,800 in the escrow account to stock in the cooperative. In fact, we promised them an opportunity to invest more than that, if they wished.

All of this “Made Sense” to 2850 spring wheat farmers in Minnesota, North & South Dakota and Montana. In the end, they amassed over \$25 million to start the company. It made sense to them, because we stayed centered on some simple truths that all the members knew, and that maintained that “Credibility”. Truths like, “it takes money to make money”. They realized that they could not do it alone, and they needed to cooperate with each other to get what they wanted.

They also realized there was a “Catch 22” in the proposition, unless they bought into the concept. If they wanted to wait and see if the deal was a good one, there wouldn’t be any money available to develop the deal in the first place. They realized they had to decide now, at the beginning, whether they were in or out, if they really wanted to add value to spring wheat. They were not going to get to wait for all the money to be spent and the work to be all done, and then have someone come by and beg them to invest.

Credibility Question #2: Who Am I Doing Business With?

For me personally, this is the more important question of the two proposed. When USWP went about organizing its steering committee, we had two criteria for those that became members. #1: They had experience in the formation of a value added cooperative. #2: They had strong expertise in the spring wheat business. In some cases, we got both in one person. The choice of these people and the signing on of their support was the single most important asset of the whole effort.

Think about it. If you don't know anybody involved in a proposition; are you going to invest in it? We all are going to ask ourselves many questions. Can I trust these people? What is in it for them? How is their track record on their business judgment? What is it about these particular people, that should make me want to put my hard earned money in their hands? These are all fair questions.

On the USWP steering committee we had exclusively farmers, and they filled the criteria for being members quite well. We had three previous members of the American Crystal Sugar Cooperative Board of Directors. They each had over 20 years of experience in being part of a value added cooperative with over \$600 million in sales. This group included a past chairman of the board. We had several members of the board of directors of Dakota Growers Pasta Company, as well as their chairman. Many of the members had owned stock and been members of the sugarbeet cooperatives for years, as well as Dakota Growers Pasta Company.

There were members on the steering committee from all four states wheat promotion commissions, wheat growers organizations, some current and past presidents from those groups, the immediate past president of the National Association of Wheat Growers and members and officers past and present of some of the regions general farm organizations. That whole group consisted of 50 members of that caliber from across the four state region. We obviously made a concerted effort to get people involved that potential members either knew or knew of their reputation. We printed their resumes in our first brochures. We wanted to leave the potential members with a feeling that "If this group couldn't do it.....who could?".

To further validate our position we did a few extra things. We took no per diem, and the executive committee of the steering committee were the only ones that got mileage, meals or lodging. This re-enforced the idea that we were truly committed. We held a composite of over 100 meetings across the region. That is a lot of work, and the members knew and appreciated it. These are all elements of rural America's tradition of "Barn Raising", showing a willingness to donate time and resources for the good of the greater group. The real truth is, we were just doing what so many have done in the past when they wanted to start a business. If they couldn't do it on their own, they asked for help.

Conclusion

This is how we went about answering those two very important questions. If you decide to get involved in value added, they are the same fundamental questions you must ask yourself and eventually answer to many other people.

Does this make sense?

Who am I doing business with?

Starting these businesses is not an academic exercise, although information is very important. You can plan and analyze till the cows come home, but success or failure is embodied in these two simple questions. Business people know that instinctively.

In the case of USWP, these two questions were answered by conducting a first class and rather expensive sales effort. We enlisted the best we could find of legal counsel to help take care of all legal matters, consultants to do the business planning, financial experts to prepare the financial projections and a very farmer specific and talented group of public relations people. They helped to get the word out over four states, and provided computer generated presentation material, proper sound and other visuals.

We also had an important educational edge in our region, and this was an important advantage to our efforts. Many of these cooperatives have been started. Some have been glowing successes. Others have been abysmal failures. Success or failure, they have made the farmer/ranchers of the upper Midwest very familiar with value added cooperatives. In general, people will not do what they don't understand. So, part of "Making Sense" is to understand the fundamentals, and that really is an education process. Isn't that what this meeting is about?

For those efforts, I applaud the organizers of these very educational outlook conferences and thank you for the opportunity to contribute.

