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STRUCTURAL CHANGE IN THE DAIRY COOPERATIVE SECTOR, 1992-2000

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Farmer-owned dairy cooperatives, as you well know, have played an important role in milk marketing from the earliest days of our Nation. While dairy cooperative numbers have shrunk, as have the number of dairy farmer members, cooperatives continue to handle a predominant share of all milk marketed in the U.S.(83 percent in 1997). And for the past 50-years or so they have distributed a majority of the dry milk products, butter and cheddar cheese produced in this country.

As a refresher, just what is a "dairy cooperative"? Basically, it is a business that is owned, operated, and controlled by the dairy farmers who benefit from its services. Beyond that, they vary widely in size and in the type of activities they undertake in order to provide members an assured market for their milk. Some are made up of a handful of producers, while others have tens of thousands of producer-members. Some solely arrange for the sale of members' milk, perform few services and do not own milk manufacturing or processing facilities. In sharp contrast, others manufacture a wide variety of dairy products in an expansive system of plants.

Changes in dairy cooperative numbers, 1992-2000

RBS-Cooperative Services is the Nation's storehouse of statistics on farmer cooperatives. The number of dairy cooperatives in the United States fell from 265 in 1992 to 213 in 2000. However, the adjustment was more dynamic than the net loss of 52 cooperatives indicates. A closer look reveals that 84 dairy cooperatives (32 percent) went out of existence and 32 new dairy cooperatives were formed by 2000.

First let's look at the exiting cooperatives. Of these, less than half dissolved or ceased operations all together. Some 48 cooperatives (57 percent of the exiting cooperatives) continued in operation, so to speak, in one fashion or another. Some cooperatives sold their operations to investor-owned firms (eight). In a few cases (four), the cooperatives' operations changed such that they were no longer classified as "dairy" cooperatives by RBS-cooperative Services. In these few cases, the cooperatives' other operations (such as feed or supplies) came to generate more total sales than their dairy sales.

A large segment exited by merging with other cooperatives (36 cooperatives or 43 percent). In many mergers, one or more cooperatives were absorbed into an on-going or "surviving" cooperative. Other mergers, or rather, consolidations, resulted in entirely new cooperatives being formed. Between 1992 and 2000, 26 of the cooperatives that exited by merger ended up being part of 6 new cooperatives that had emerged by the end of the period.

Characteristics of the exiting cooperatives

There were some differences in the characteristics of the exiting cooperatives depending upon how they exited. The ones that dissolved and left no successor organization tended to be small (had handled less than 50 million pounds of milk annually). They were usually bargaining-only cooperatives that operated no manufacturing or fluid processing plants. Most had exited by 1996 and were

located in the Upper Midwest or North Atlantic. Former members then joined other cooperatives, formed new ones or resorted to selling their milk directly to milk plants.

In contrast, the cooperatives that exited by merging with or into another dairy cooperative were mostly medium (36 percent) or large (42 percent) sized (handled 50 to 999 million pounds of milk or 1 billion pounds or more annually, respectively). While a majority of the merging cooperatives were manufacturing/processing cooperatives—cooperatives that sell raw bulk milk and operate one or more plants to manufacture milk into various products, quite a few merging cooperatives were bargaining-only cooperatives (42 percent). One half merged in 1997 or later. The cooperatives that merged were headquartered in every region of the U.S.

Cooperatives combined with other dairy cooperatives for various reasons such as: to take advantage of scale economies; to better configure and utilize a system of manufacturing plants and to reduce operating overhead; to foster marketing clout; and to secure milk supplies, often eliminating overlapping activities, such as milk pick-up routes. Another driving force behind the mergers was to keep pace with consolidation in the fluid processing and retail sectors, thereby allowing the unified cooperatives to supply larger volumes and meet customer product requirements through horizontal integration.

Also, the increased ability to transport milk due to improvements in trucking, milk quality and milk handling– as well as advanced packaging technology—may have facilitated this consolidation between dairy cooperatives. Furthermore, the increased merger activity the last three years of the century may have, in part, been a result of cooperatives anticipating and reacting to the new, consolidated Federal Milk Marketing Orders (FMMO), which went into effect Jan. 1, 2000. The mergers expanded the geographical reach and market power of the surviving/emerging organizations and by 2000 some dairy cooperatives' memberships spanned multiple regions or were even nationwide, while the number of states housing dairy cooperative headquarters shrunk.

Those cooperatives acquired by Investor Owned Firms (IOF) were mostly small (75 percent) and owned or operated manufacturing/processing plants (75 percent). Most had exited prior to 1996 (75 percent). They were located mostly in the North Atlantic (50 percent) and Upper Midwest (38 percent).

Characteristics of the new cooperatives

In the last 9 years of the 20th century, 32 new dairy cooperatives formed. Six of these were formed by consolidations. The rest (26 cooperatives) were formed by new groups of producers.

As could be expected, the new cooperatives resulting from merger activity were mostly large and none were small. Three were bargaining-only associations and three were manufacturing/processing cooperatives that produced a wide variety of products.

The 26 cooperatives formed by new producer groups were mostly small (62 percent), bargaining only (69 percent) cooperatives. A large number of them (39 percent) were formed in the North Atlantic region and most (69 percent) were formed in the last 4 years of the 9-year period. The minimal financial commitment required to form and operate a bargaining-only cooperative contributed to their ease of formation and dissolution.

These new groups of producers banded together for a variety of reasons. Some formed to capture marketing margins by further processing their milk, focusing on a particular market niche. Commonly, the market niche was specialty cheese—a unique variety or product with distinguishing characteristics (perceived or real) such as "organic," "rBST-free," "locally produced," "grass-based," etc.

One group formed with the intention of processing branded fluid milk and capitalizing on similar types of attributes. And some of these efforts were a small-farm survival strategy.

Additionally, some dairy farmers may have been seeking other alternatives to the “mega-cooperatives” for their marketing needs in forming a few of these new organizations. Others were formed by groups of new dairy operations that were similarly situated. Several of the new dairy cooperatives may have been, in essence, successors to cooperatives that had gone out of business for a time.

Adjustment in Dairy Cooperative Operations

Dairy cooperatives have taken diverse roads to address their specific marketing needs, but each has its merits. Cooperatives engaged solely in bargaining activities increased their share of total cooperative numbers. They made up 74 percent of the Nation’s cooperatives in 2000. However, they represent just one-fourth of the milk handled by cooperatives.

Underlying the changes in cooperative numbers is a shift away from operating manufacturing plants on a small scale for market balancing. As the 20th century wound up, many of these balancing cooperatives closed their aging manufacturing facilities but continued their bargaining activities. Maintaining small, under-utilized and old balancing plants is costly, while building new, large-scale plants is also expensive, particularly for small cooperatives.

Similarly, there was also a move away from cooperatives operating large, high volume plants for the production of a single or limited variety of commodity, or undifferentiated, dairy products, such as butter, powder and bulk cheese. The limited flexibility of a narrow product line probably left them more vulnerable to inventory losses arising from the volatile milk prices of the 1990s than a more diversified product line would have. Many of these commodity manufacturing cooperatives merged with diversified cooperatives — cooperatives that own a system of plants to make a variety of products — both differentiated and commodity, while at the same time selling a large portion of their milk supply to other handlers and performing the requisite bargaining services. The consolidation of commodity manufacturing cooperatives with (or into) diversified cooperatives improved flexibility in product mix and efficiency with a more rationalized system of plants. Some plants were closed when they could not be utilized efficiently within the new system of plants. Diversified cooperatives offer milk and dairy product buyers a full range of services while securing marketing margins and security for their members.

Diversified cooperatives are the least numerous of the operating types but they account for over one-half of all milk handled by the nation’s dairy cooperatives. Their shrinking numbers truly reflect the fewer-but-larger trend and represent increasing horizontal, as well as vertical, coordination. An indication of their vitality is that none of the exiting diversified cooperatives dissolved or went out of operation. Instead, all but one merged or consolidated with other cooperatives.

Taking an alternative approach, some cooperatives manufacture selected products on a smaller scale for a particular market niche—typically cheese. An equal number of cooperatives making specialty products for a “niche” market exited as were formed in the last 9 years of the decade. These are the second most common type of dairy cooperative today. They are mostly small cooperatives, hence represent a small portion of the milk handled by cooperatives.

The number of cooperatives engaged in processing fluid milk is small and shrunk further between 1992 and 2000. The exiting fluid processing cooperatives merged into other dairy cooperatives or were acquired by an IOF.

Summary

In conclusion, dairy cooperatives have shown their ability to successfully adapt to the changes in the marketing environment. Thus, dairy producers will continue to have a variety of cooperative avenues to meet their needs and preferences in marketing their milk.

The strength of the Nation's dairy cooperatives has allowed milk producers to maintain the independence of their farm firms. They have been able to maintain their autonomy while gaining some "muscle in the marketplace" through their cooperatives. Dairy farmers likely will continue to employ the cooperative business form to market their milk long into the future.