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THEME OVERVIEW: CRITICAL ISSUES FOR AGRICULTURAL COOPERATIVES

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Cooperatives are user owned businesses that are an important part of the U.S. economy and particularly prevalent in the agricultural sector. In 2009, cooperative businesses in the United States controlled over \$3 trillion in assets, generated nearly \$654 billion in revenue, employed over 2 million people and distributed nearly \$79 billion in income to user/owners. Agricultural marketing cooperatives generate nearly \$130 billion in revenue and over 200,000 jobs (Deller et al. 2009). Cooperatives operate under a business model that generates unique challenges in financial management, governance, strategy and communication. These unique challenges and the prevalence of cooperatives in U.S. agriculture have encouraged research and education efforts by agricultural economists since the early 1900's. Cooperatives were included as a part of the mission of the Cooperative Extension Service in 1926 and the USDA has maintained research and statistical staff focusing on cooperatives for over 50 years. A National Institute of Food and Agriculture (NIFA; formerly CSREES) Regional Research and Extension Committee for cooperatives has been active since 1993, making it one of the longest running such committees in the United States. Cooperatives, as an industry, are among the most generous supporters of departments of agricultural economics with more than \$20 million invested in scholarships, faculty, and other endowments in at least 14 different departments. In addition, more than \$150,000 of scholarships are awarded annually by cooperatives to undergraduate students in the United States and another \$100,000 for graduate student research.

A review of academic archiving services yields thousands of citations with "cooperative" listed as a key word. Some of these studies have discussed the economic models that can be applied to a cooperative. Agricultural cooperatives have been analyzed as a form of vertical integration as; a unique form of firm; as a set of implicit and explicit contracts between farmer members, managers and employee; and as a coalition. Other studies have considered the cooperative's role and impact in the market place. Firm level research has analyzed the structure and performance of the cooperative firm—including financial structure, taxation, marketing activities, strategy, and membership involvement.

The interest of agricultural economists in agricultural cooperatives is understandable and appropriate. The cooperative business model creates unique challenges and economic questions which agricultural economists are positioned to address. In addition, since agricultural cooperatives are owned by and designed to benefit producers, cooperative related research has the potential to benefit a large number of farmers. Almost 715,000 farmers are members of agricultural marketing cooperatives (Deller et al., 2009).

There have also been a number of efforts to identify challenges, critical issues and success factors for agricultural cooperatives. This Choices theme reports on the most recent effort. The objective of this series of articles is to summarize current challenges and needs within the cooperative community. The insights were gained from a panel of cooperative leaders (Table 1) and USDA and academic experts. Similar panels have been organized in every decade since the 1970s and have helped the academic community develop research and outreach programs. The panel met August 4, 2011 in Washington, D.C. and was organized by the Council on Food, Agriculture, and Resource Economics (C-FARE). The CHS Foundation sponsored the event. A diverse spectrum of business areas including raisins, oranges, grain, farm supply, dairy, bio-energy, farm credit and local foods were represented. The challenges and issues for cooperatives were identified through a two-stage modified Delphi survey process and a face-to-face focus panel discussion. A Delphi survey is a multi-stage expert survey in which the opinions and information from the first stage are used to refine the second and subsequent stages. In this case, the first stage was an open-ended survey in which the panel identified and described challenges and critical issues. In the second stage, the panel members rated the importance of the major issues identified in the first stage. Twenty-five cooperative leaders received the survey, 18 responded to the first stage and 19 responded to the second stage. The degree of response, particularly by members of the cooperative business industry—including CEOs of major cooperatives, suggests there

is an important constituency that values research on agricultural cooperatives and is interested in engaging with the agricultural and applied economics profession.

Table 1

Cooperative Organizations Represented on the Expert Panel

- Ag First Farm Credit Bank
- CHS
- CoBank
- Farm Credit Services
- Federation of Southern Cooperatives
- Land O Lakes
- Michigan Milk Producers
- Mid-America Cooperative Council
- National Cooperative Business Association
- National Council of Farmer Cooperatives
- Oklahoma Food Cooperative
- Southern States Cooperative
- Sunkist
- Sun-Maid
- West Central Cooperative

In this article, we introduce the topics identified as challenges and issues currently affecting the success of cooperatives. Subsequent articles in this theme explore the relationship between these challenges and issues, the current nature of the agricultural economy, and the interaction of these conditions with achievement of farmer-owner objectives, subject to the constraints of the cooperative business model.

External Issues

The panel reported that a variety of issues external to cooperative firm are impacting them (Figure 1). Volatility of commodity and input markets was perceived as the most important issue. The panel indicated that recent market

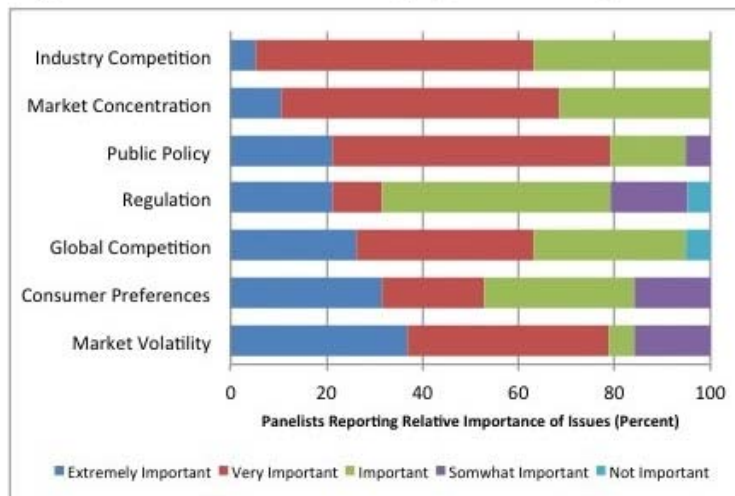
External Issues Affecting Agricultural Cooperatives

Public policy, global competition, industry competition and market concentration were all perceived as extremely important or very important issues. Interestingly, specific environmental regulations and issues including green house gas emissions and genetically modified organisms were not ranked as highly important. Consumer preferences were rated as “extremely important” by nearly a third of the panel.

Internal Challenges and Issues

The panel identified a number of challenges and issues which are inherently important to cooperatives, and must be dealt with in the context of the external environment in which they operate.

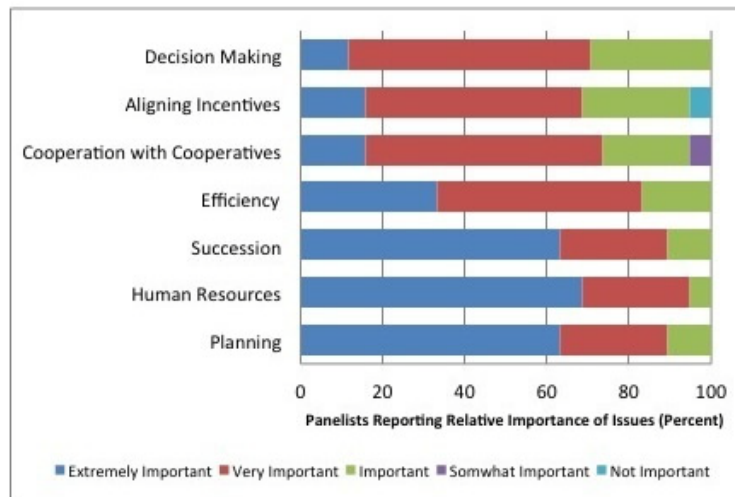
Figure 1: External Issues Affecting Agricultural Cooperatives



Strategy Issues

These outside forces impacted the collective perception of the strategic issues facing cooperatives (Figure 2). McKee, Boland, and Hogeland summarize the findings and research needs in strategy in another article. Almost 90% of the cooperative leaders viewed the need for effective strategic planning as an extremely or very important issue. Aside from planning, human resource issues dominated the strategy area. The succession of management and key personnel, attracting and maintaining high quality personnel, and aligning the incentives of managers and employees with member interest all received high importance ratings. A third of the respondents viewed gaining efficiency and maintaining viability in their market segments as an extremely important issue, while 12% gave extreme importance to the cooperative's ability to make effective, timely decisions. The ability of the cooperative to pursue alliances with investor owned firms or with other cooperatives was also considered important.

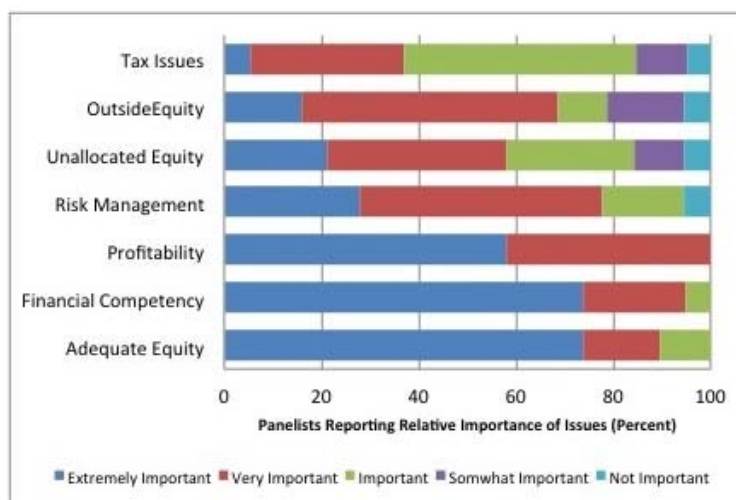
Figure 2: Strategy issues Affecting Agricultural Cooperatives



Finance and Equity

Respondents identified several financial issues of current importance to the success of cooperatives. The Barton, Boland, Chaddad, and Eversull article summarizes the challenges and research suggestions in the finance area. The panel indicated that acquiring and maintaining adequate equity was the most critical challenge. This issue is related to the features of the cooperative business model since cooperatives often create equity out of the profit stream and simultaneously manage systems to return—redeem—that equity to members. It is therefore not surprising that maintaining sufficient and consistent profitability and risk management were also considered key issues.

Figure 3: Finance Issues Affecting Agricultural Cooperatives



The panel identified two other financial challenges related to acquisition of equity. The use of outside, nonmember equity was considered important. The majority of the panel also considered the recent trend of creating unallocated equity—retaining earnings—instead of issuing stock to individual members as an extremely or very important issue. The complexity of these challenges is further evidenced by the fact that the panel considered the financial competency of both managers and directors an extremely important issue.

Governance Challenges

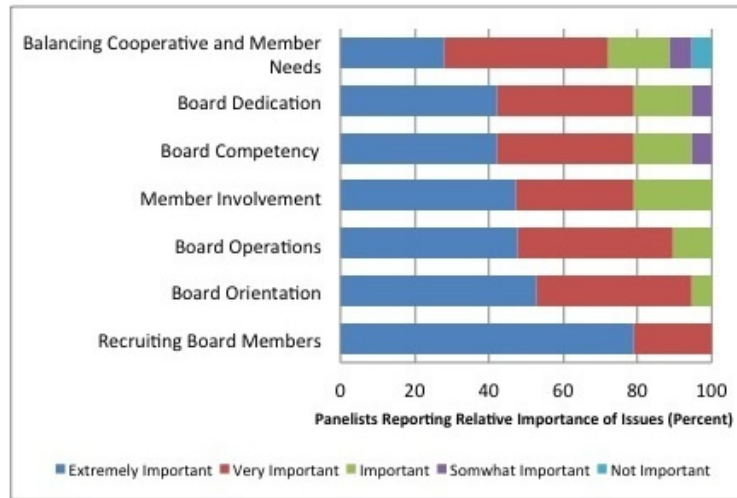
The fact that agricultural cooperatives are governed by producer-members is both a key strength and a key challenge for cooperatives. Hueth and Reynolds summarize the issues and need for future research in this area. The key governance challenge (Figure 4) is that of identifying and recruiting directors with the essential mix of skills. Member involvement in a cooperative—another key issue—often relates to their access to board members or interest in running for the board. Other governance issues identified by the panel were related to the effectiveness and performance of the board of directors. The addition of outside, non-member directors has been a recent development in agricultural cooperatives, and according to the panel, is an important issue facing modern cooperatives.

Communicating Value

The panel identified a number of issues relating to communications (Figure 5).

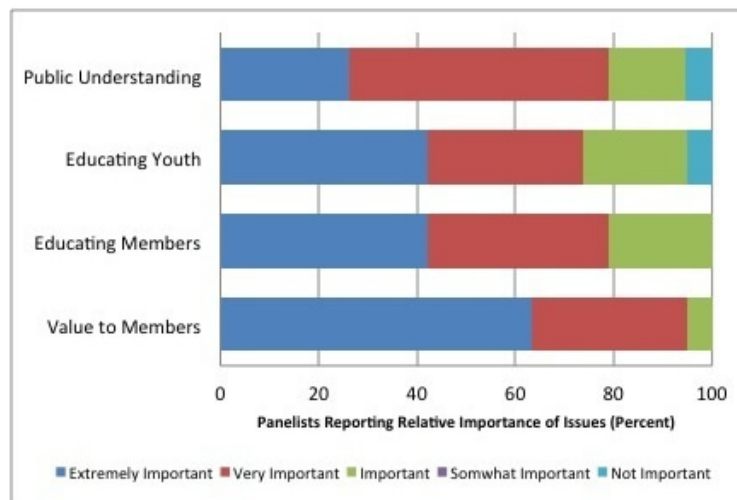
Bond and Bhuyan summarize these issues and discuss research needs. All businesses, including cooperatives are formed to create and deliver value to their customers and owners. The cooperative member is both user and customer and this creates tension in generating and allocating economic benefits. This also creates unique challenges in communicating the value of the cooperative to both its members and to the general public. Communicating the value of the cooperative to its member owners was the most critical communication challenge identified. Cooperatives create value through the prices they provide members, access to the market place, unique services provided, counteracting market power, and of course, the financial return created at the cooperative level. Communicating this complex value package, particularly to large producer-members, was identified as a key issue.

Figure 4: Governance Issues Affecting Agricultural Cooperatives



Related to this issue is the challenge of educating members so they understand and participate in decisions on retaining funds, managing equity, distributing profits and rationalizing business operations. Reaching young producers and young potential employees is also an important issue as is improving the public understanding of the cooperative business model. The panel noted that cooperatives have struggled to develop a simple unified message that describes the value of the cooperative business model across all sectors of cooperatives.

Figure 5: Communication Issues Affecting Agricultural Cooperatives



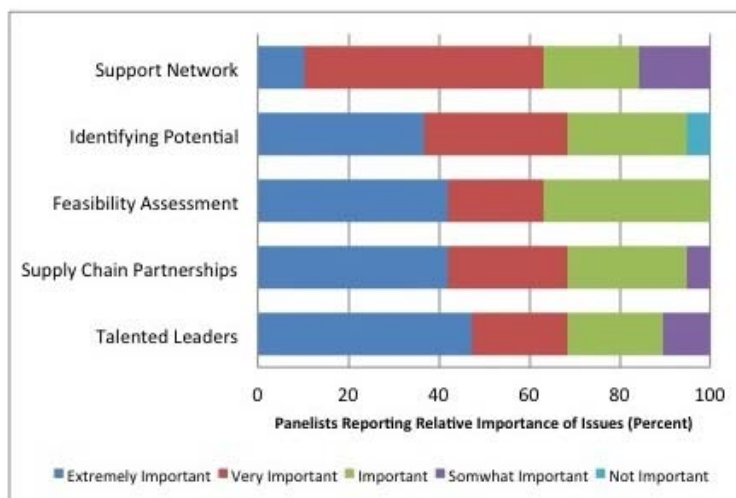
New Cooperative Development

Newly organized agricultural cooperatives experience challenges distinct from those facing established firms. Henehan, Schultz and Hardesty summarize these new cooperative development issues and research needs. Cooperative membership—and therefore ownership—is dynamic and is limited to the current users of the business. Thus, founding members of a cooperative may have a very different perception of the firm’s value in comparison with future generations. Surprisingly, the panel indicated that many issues facing new cooperatives are similar to those described as facing established cooperatives (Figure 6). Acquiring significant equity, and identifying and attracting knowledgeable leadership, are viewed as key impediments to the development of successful cooperatives. Other key issues facing new cooperatives include developing partnerships within the supply chain, and accurately forecasting demand and business feasibility. The panel commented that managers and board members of new cooperatives need linkages with their counterparts in established, successful firms.

Challenges and Opportunities

One of the most significant results from the discussion of the panel of cooperative experts is their willingness to participate. All of the cooperative leaders who were contacted were enthusiastic about the project. The industry panel participants, who included CEOs of major cooperatives, invested the time to respond to the two-stage survey and to travel to Washington D.C. to participate in the focus group discussion. Agricultural economists should take note that there is an important industry constituency that values the research conducted by land grant universities and is interested in engaging with the profession. Such public-private partnerships are critical for land grant universities and the partnerships with cooperatives are a crucial part of many departments of agricultural economics.

Figure 6: New Cooperative Development Issues



While many of the critical challenges and issues identified by the panel are not unique to agricultural cooperatives, most had unique implications. The cooperative business model has different structures for equity creation, profit distribution and governance relative to investor-owned firms. The economic relationship between a cooperative and its members and users is different from that of an investor owned firm. This leads to challenges and opportunities for cooperative leaders and research questions for agricultural economists. The following articles in this theme provide a summary and discussion of these issues. The various authors, among the leading cooperative scholars in the United States, discuss issues relating to strategy, finance, governance, communication and new cooperative development. The common theme of these articles provides insights into how the unique business structure of agricultural cooperatives influences their relationship with producer members and their competitive environment.

For More Information

Deller, S., A. Hoyt, B. Hueth and R. Sundaram-Stukel. (2009). *Research on the Economic Impact of Cooperatives*. University of Wisconsin Center for Cooperatives. Available Online: http://reic.uwcc.wisc.edu/sites/all/REIC_FINAL.pdf

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