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**AgGuild of Illinois: A New Generation Cooperative without
the Bricks and Mortar**

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Abstract

In response to low commodity prices and increasing production cost, agricultural producers have attempted to capture a portion of downstream market value of their products by organizing and investing in what are now called “New Generation Co-ops”. These cooperative efforts often involve the construction of processing facilities (soybean crushing, corn processing, wheat milling) requiring an extensive capital commitment and a substantial financial risk for their members. An alternative strategy to the brick and mortar cooperatives are producer affiliations that involve the negotiation of contractual agreements with product users, providing protocols for maintaining quality standards, and collecting and sharing information. AgGuild of Illinois is an example of such a producer cooperative arrangement. The AgGuild, an alliance of some fifty central Illinois grain producers, attempts to capture a premium over the general commodity grain price by producing crops in viable quantities that meet the quality and attribute specifications desired by contracting users. To this point, the AgGuild has focused its efforts on producing non-genetically modified soybeans that have higher yields of isoflavones (a naturally occurring chemical compound in plants that are considered to provide a number of health benefits for consumers). The AgGuild attempts to capture a premium over the general commodity grain price by producing crops in viable quantities that meet the quality and attribute specifications desired by contracting users. To this point, the Guild has focused its efforts on producing non-genetically modified soybeans that have higher yields of isoflavones. This paper describes the operation of the AgGuild, assesses its current status and identifies some potential future challenges.

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Structural changes in production and marketing have resulted in declining margins for agricultural producers and a corresponding loss of market power of individual producers. Growers generally attempt to increase market power by expanding horizontally (controlling more production) or vertically (retaining ownership down the marketing channel). One strategy that has generated a great deal of interest and discussion has been producers' efforts to capture a larger portion of the downstream value of agricultural products by organizing into what have been termed "New Generation Cooperatives (NGC)". NGC's first emerged in the upper Midwest in the 1970's, but became increasingly common and popular in the 1990's. The creation of a NGC often involves a group of producers in a particular geographical area, producing a similar commodity, vertically integrating by purchasing or constructing processing facilities. Unlike traditional cooperatives, membership in a NGC is restricted and delivery obligations are allocated among the members (Stefanson et al., 1995). NGC processing plants produce a wide range of products from pasta to pork, but the common characteristics of NGCs have been physical structures, significant start-up costs and relatively high levels of financial risk for cooperative members.

An alternative business model to a NGC is a producer alliance. An alliance is an organization of producers that undertake a cooperative effort to gain value by providing end users with a sufficient quantity of a product with guaranteed attributes rather than

adding value through physical processing. This paper focuses on one such alliance, AgGuild of Illinois.

The concept of guilds dates back to the Middle Ages when groups of merchants and craftsmen became members of exclusive and self-governing organizations created for economic protection and mutual aid. Although the guilds of the 11th and 12th century had a variety of goals ranging from market protection to civic leadership, one of the primary guild objectives was to “monitor the quality of merchandise and coordinate the manufacturing of complex products” (Richardson, 2004). Similar to the guilds of centuries ago, the primary objective of the AgGuild is to add product value by guaranteeing the quality characteristics of the grain Guild members produce. AgGuild is engaged in what Goldsmith and Gow (2001) term relationship management. Rather than investing in plant and equipment, producers take advantage of their knowledge and expertise to meet a perceived marketing need or opportunity. AgGuild attempts to develop relationships with end users of grain desiring a product with rigidly specified quality characteristics and in quantities considered to be economically viable for both parties. Similar to NGCs, membership in the AgGuild is closed and delivery rights are distributed among members; however, the by-laws of the Guild specifically prohibit the construction of physical facilities.

In 1999, thirty-four central Illinois grain producers organized the AgGuild of Illinois. The Illinois Soybean Check-off Board as well as the local county farm bureau and cooperative extension service provided early financial and technical advice as well as administrative support. Chartered as a Limited Liability Corporation (LLC), the initial cost of joining was a \$500 cash contribution and a commitment from each member to

allocate up to at least 200 acres or 10% of the member's tillable acres (whichever is less) to the production of grain that meets the specifications of contracts negotiated by the AgGuild.

Currently, there are 55 members in AgGuild that have committed up to 22,000 acres to AgGuild contracts. The contract negotiations with the end users determine that actual acreage for a given year. To date, the contracted acreage has been relatively stable (between 10,000 and 12,000 acres) and has corresponded closely with the acreage AgGuild members have been willing to commit.

AgGuild members elect a Management Board that oversees contract negotiations, allocates acreage contracts among AgGuild members, and collects and disseminates production information among members.

Prior to the growing season a paid consultant negotiates procurement contracts with end users. These contracts determine the number of acres required for the production of a specific grain, the approved variety(ies) of grain to be produced, the protocol used to guarantee identity preservation, the delivery location and the premium over futures the AgGuild will receive. To date, the only grain produced by the AgGuild under these contracts has been identity preserved non-genetically modified high isoflavone soybeans. These beans are used in food products that are promoted as non-genetically modified with the health benefits associated with increased levels of isoflavones. Prior to planting, the Management Board allocates the number of acres each AgGuild member will devote to the production of the specialty grain. The allocation of acreage is based on a democratic process that seems to have been successful in minimizing conflict and competition among the members

AgGuild members must follow strict production and handling protocols. Growers must retain all receipts for seed purchased, planter and drill boxes must be inspected and cleaned, and combines, trucks and storage bins must be swept and cleaned. The fields used in the production of the grain must have a minimum 20-foot borders between the identity preserved grain and other crops that may be genetically modified. The contract gives the buyer the right to access the fields, harvesting equipment, transportation vehicles and grain storage facilities used in the production of the specialty grain to verify that protocols are being followed. The contract is a buyer's call contract, meaning that the grain is delivered to the processor at the discretion of the user. The buyer is committed to purchase all the grain produced on the contracted acres rather than a specific number of bushels. If the buyer does not need all of the grain, it is simply sold at commodity prices and the buyer makes up the premium difference.

Because the Illinois Grain Code requires that grain moving to processors be merchandised by a licensed grain dealer, a local grain cooperative has been contracted by AgGuild to coordinate the marketing and delivery of the grain. Approximately 50% of the AgGuild grain is stored on-farm with the balance being stored in two designated elevators owned by the grain cooperative. The buyer contacts the grain cooperative each month indicating the quantity and the date the grain is to be shipped to a local processor.

In 2004, the negotiated premium for the non-genetically modified high isoflavone soybeans is \$.80/bu. Five cents per bushel goes directly to the AgGuild for consultant salary and overhead. Another \$.05/bu pays for the local grain cooperative to coordinate the marketing and delivery of the grain. The remaining \$.70/bu goes to the producer. This premium for the AgGuild guaranteed identity preserved, high isoflavone soybeans

represents an additional \$.20 to \$.30 per bushel over the standard non-GMO premium for soybeans. The premium earned by the AgGuild has steadily but modestly increased during its five years of operations.

Producers interviewed for the case study indicated that although they would like to receive a greater premium, the existing premium structure is sufficient to offset the additional cost of producing the contracted varieties. They indicated that there is no apparent “yield drag” with the varieties being grown. There are additional labor costs associated with the production and marketing protocols and there are additional crop protection expenses associated with the production of non-GMO soybeans. The producers expressed confidence in the Management Committee to promote AgGuild’s unique characteristics to potential clients and to allocate the contracted acres in an equitable fashion.

The AgGuild of Illinois can be considered a successful economic venture for its members. Additional returns generated have been sufficient to cover additional costs required by the production and handling protocols. The success of the AgGuild is indicated by the growth in the number of members, the increase in the contract premiums and an increased value of membership in the AgGuild (currently \$1,200 compared to the charter membership cost of \$500). Guild membership has grown steadily and there is a waiting list of producers interested in joining the organization.

As with most business organizations, AgGuild is and will be confronted with challenges. At this point in time, AgGuild has contracts with a single end user. If this end user no longer needs AgGuild services, the organization will be in obvious jeopardy. Additionally, the characteristics of the specialty grain currently produced under contract

may become problematic. The health merits of the high isoflavone soybeans are somewhat controversial. If isoflavone in diets becomes a passing health fad similar to the oat bran phenomenon of a few years ago, the isoflavone portion of the premium may simply disappear. Expanding the customer or end user base is imperative to the long run survival of the alliance. AgGuild leadership is cognizant of the problem and is exploring the possibility of full-time, professional staff that can devote time and effort to pursuing additional opportunities for the AgGuild.

Acreage allocation among members is a potential source of conflict within the AgGuild. The relatively modest premiums that are being earned by members appear to contribute to a seeming absence of conflict among members for the contracted acreage. However, a dramatic increase in premiums and a corresponding increase in the profitability of participation could lead to competition among members for acreage allocations. An explicit formula for allocating the contracted acres may be needed to avoid misunderstandings and the perception of favoritism by the Management Board.

AgGuild operations rely on two firms that are outside of the Guild's control. The first is the grain cooperative that stores and merchandises AgGuild grain. The management of the cooperative indicates that their firm provides these services basically at cost and as a service to their customers. Several of the AgGuild members sell their commodity grain through this cooperative. The second firm is the local soybean processor. This small scale processing facility, by industry standards has the flexibility to cease day-to-day operations, clean the required machinery and equipment and processes the contracted soybeans. This processing normally takes place one day a month. If one

or both firms would cease to cooperate, the AgGuild may have difficulty establishing workable relationships with other firms.

In summary, AgGuild of Illinois has taken advantage of membership knowledge and innovation to establish itself as a credible organization that is able to provide grain users with a product that is guaranteed to follow established protocols to meet the user's required quality traits. This relationship management has allowed the AgGuild members to add value to their product and increase income without the financial risk of investing in physical plant and equipment. Growth and continued success of the AgGuild will depend many factors. The element that is likely to be most critical in the long run economic health of the alliance is its ability to identify appropriately profitable contract opportunities. This is no simple task, as the product needs to have narrowly defined and identifiable characteristics (a niche) yet be needed in sufficient quantity to be profitable for AgGuild members. Premiums need to be sufficient to cover additional production and handling costs but not so high that they result in internal conflict within the AgGuild or attract competitors that may bid away the market.

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