



AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search

<http://ageconsearch.umn.edu>

aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

New Generation Cooperatives

New Generation Cooperatives: External Environment and Investor Characteristics

*David W. Cobia
North Dakota State University*

I have been asked to comment on the external environment that may have influenced cooperative development in North Dakota, and to report on differences between farmers that do and do not invest in new generation cooperatives. Research underway regarding these topics supports, in the main, hypotheses advanced by others (e.g., Harris, Stefanson and Fulton; Sexton and Iskow) regarding the external support system for cooperative formation and characteristics of farmers who invest in them.

External Environment

At least part of the motivation for cooperative formation arises from economic and social conditions. One cannot be entirely sure which ones are critical. Nevertheless the following conditions have been mentioned as important to cooperative formation in North Dakota. Nationwide, farm income has become more volatile. North Dakota shares in that experience. But farmers have, in general, been making financial progress. They are better off financially in real terms than in the past. Reducing income volatility is considered a stick for cooperative development, and improved income provides the means to invest in new cooperatives.

The threat, and now the realization, of the retrenchment of governmental farm subsidies is frequently mentioned as another stick. Retrenchment of farm subsidies is particularly important to North Dakota where there is a high

participation in government programs and government payments represent a higher proportion of net farm income than in other states. With this safety net evaporating, cooperatives are seen as a vehicle by farmers to take greater control of their economic circumstances by integrating forward to achieve a more secure market, capture profits at the next level, and to carry the reality and image of quality control to the consumer.

North Dakota suffers from the too-much, too-late mistake. By the time the economic and social infrastructure designed for rail and horse-and-buggy technology was in place, it was woefully outdated. We had towns located every six miles on rail lines thirty miles apart to accommodate a one-day, round trip between farm and town with a team of horses and wagon. Ever since truck transportation hit the scene we have been making painful consolidations.

Declining rural population coupled with the farm crises and an oil bust in the late 1980s created a morose mind-set regarding the state's economic future. Popper's prophecy that North Dakota would return to its original presettlement condition of "Buffalo Commons" incensed North Dakotans and helped galvanize them into activity. A nonpolitical effort, Vision 2000, sponsored by the Greater North Dakota Association (a statewide chamber of commerce) developed an evaluation of the state's economy and prepared a planned response for economic development. Citizens were asked at town hall meetings if North Dakota was dying. They said,

"Yes, it will die, unless we change the way we look at things," and indicated they were eager to begin finding solutions for turning around the sagging economy.

An eight-point action plan was devised for the four major sectors of agriculture, energy, manufacture and service. A collaboration took place in the fall of 1990 between the efforts prompted by Vision 2000 and the governor's economic development initiatives resulting in legislative programs expansively referred to as "Growing North Dakota." One goal was to encourage collaboration to exploit value-added processing of agricultural products in the state. The mission and resources of the formerly created Agricultural Products Utilization Commission (APUC) were expanded. In its current form this agency has about \$1,000,000 per year for projects "...to create new wealth and jobs through the development of new and expanded uses of North Dakota agricultural products" (see Agricultural Products Utilization Commission). One of the four categories is "Cooperative Marketing," intended to encourage groups of farmers to "develop innovative marketing strategies."

Private agencies took action as well. Utilities have been particularly active. The North Dakota Association of Rural Electric Cooperatives, for example, hired an economic development specialist. It also awarded non-interest bearing loans for economic activity.

The creation of four sugar beet cooperatives in the region in the early 1970s and their subsequent success was a seminal event. These cooperatives were a radical departure from the traditional co-ops in the Midwest, particularly in North Dakota. They shattered old perceptions and created a new mind set regarding such key factors as member investment and transferable delivery rights and obligations. Many, but not all, of the champions of new generation cooperatives cut their teeth in the sugar beet cooperatives. Fortunately several farmers stepped forward, making personal sacrifices as they took the initiative to bring ideas into reality.

These changing economic conditions and events are thought to have created a climate conducive to cooperative development in North Dakota. This is the conventional wisdom. We have no scientific evidence, no t-tests or chi squares supporting these conclusions.

External Support System

Waves of cooperative development depend on external support systems (Harris, Stefanson and Fulton). We have conducted seventeen interviews, seven with new generation cooperative steering committee members, five with governmental officials and five with private consultants in an effort to make judgments regarding the role and relative importance of various elements of that external support system. These data have not yet been systematically analyzed, however, some themes emerge.

The two outside agents standing head and shoulders above the rest are organizational catalysts and financial grants to support the organizational phase. Several other factors are important "foothills" to these two mountains of support.

The most unique and critical talent early on is the organizational catalyst. This person facilitates communication as the group moves through the early organizational phases, especially the gut wrenching process of achieving the central business proposition, and provides information on qualified consultants. Organizational catalysts also provide guidance in timing of the various phases of development. Opinions vary concerning the ideal agency to sponsor this difficult-to-duplicate talent. The home organization must provide an unbiased base, free from political, pecuniary and related biases.

A second critical resource is financial grants to support the organizational phase of cooperative formation. The business plan typically requires an expensive feasibility study. Funds are required for lawyers, accountants and other consultants to prepare the business plan and

prospectus. The equity drive itself is not cheap. In North Dakota external funding for these purposes has been secured primarily from APUC. This program is consistently pointed to as most critical, both in the requirements of the grant request and the timing of its award. Grant requests call for matching funds from potential members. Seed money from prospective members is a measure of their commitment to the project. The grant request also requires a preliminary plan demonstrating that there is some justification, that the project is economically feasible. This process filters out many pie-in-the-sky projects. With timely grants and potential member seed money, the steering committee can finance a quality feasibility study and the preparation of a business plan and prospectus on which the steering committee can conduct their equity drive and secure conditional debt financing.

An important North Dakota "foothill" is the "Marketplace of Ideas," first organized in 1989 by State Commissioner of Agriculture Sarah Vogel and Senator Kent Conrad. This annual open house is intended to create enthusiasm for new markets and new product development and provides networking opportunities to carry out these ideas. This is accomplished with a display area in which booths can be set up to promote new ideas; workshop sessions on new enterprise development; and meetings of special interest groups to discuss, explore and organize. It also facilitates networking between groups interested in new ventures and agencies providing support. Attendance at Marketplace has grown from about 600 in 1989 to 5,000 in 1996.

Another critical "foothill" is a pool of qualified private consultants, attorneys and accountants. Not all of these professionals are created equal. A few of them have developed expertise in which steering committees can have confidence.

The St. Paul Bank for Cooperatives has played a pivotal role in guiding new cooperatives in their formative stages as well as extending debt capital to the cooperative itself. Com-

mercial banks, credit unions and especially the Farm Credit System have actively loaned funds to farmers for their equity investment in new cooperatives. The state-owned Bank of North Dakota extends credit both to cooperatives and to investing farmers in its effort to promote the state's economic development. Several other support systems play helpful roles in specific situations. They include communities, regional economic development commissions, individual RECs, and North Dakota State University's Extension Service.

Other activities are intended to aid in the continuation of new cooperative formation. Included are the training conferences for steering committee members and economic development professionals held in North Dakota, Minnesota and Saskatchewan and a periodical and video on cooperative development prepared by the Minnesota Association of Cooperatives.

Investor-Noninvestor Differences

To test hypotheses regarding investor-noninvestor differences, we surveyed farmers who joined new generation cooperatives and those who attended new cooperative information meetings but did not join. We conducted a telephone interview and a follow-up survey of farmers who had an opportunity to invest in four cooperatives (Dakota Pasta Growers, North American Bison Cooperative, Dakota Specialty Dairy, and Golden Growers). Of the 553 farmers completing the phone interviews, 318 (191 investors and 127 noninvestors) returned the mail survey.

Characteristics

Personal characteristics were as hypothesized, but the differences were not as great as many observers had estimated. Investors compared to noninvestors were younger (44.3 years of age vs. 47.6), better educated (3.2 years

beyond high school vs. 2.7 years), and had less farming experience (21.8 years vs. 25.4 years).

Investors did not own significantly more land, but they farmed more land and were members of more cooperatives than noninvestors. Investors net worth was nearly double that of noninvestors (Table 1).

Table 1. Investor/Noninvestor Net Worth

Item	Investors	Noninvestors	Difference
Member of supply/marketing co-ops	4	3	1*
Acres owned	1,113	955	158
Acres farmed	2,349	1,707	462*
Net worth (\$000)	625	387	47*

*Significant at 1%

Perceptions

Even though the differences were significant, the best predictor of cooperative investment was how farmers viewed themselves in the food system and how they saw the cooperative fulfilling economic objectives. Investors tended to view themselves in the food processing business more than noninvestors (Figure 1). This same relationship existed for other vertical forward functions, but the differences were not as pronounced.

As expected, investors felt new generation cooperatives would help increase income, reduce market risks, gain market access, and provide service more than noninvestors (Figure 2).

Noninvestors were more inclined to agree with negatively worded statements regarding criticisms of new generation cooperatives (Figure 3). The t-values were largest for the statements of: investments are too high, they benefit only the wealthy, and contracts are too strict.

Risk and Rate of Return

Are there differences between investors and noninvestors in their perception of long-term risk and expected rate of return from investments in new generation cooperatives? This information was collected using the statement in Table 2. We found significant and consistent patterns in their comparisons of these investments with stocks, bonds, mutual funds, CDs, land, and other farm enterprises (Figure 4). Values on the vertical and horizontal axis (1 = much lower, 3 = the same, and 5 = much higher) depict the average for each group. Included on this chart are corresponding data from a survey of 215 agricultural loan officers.

These observations match up pretty well with our perceptions of risk and rate of return of the five investments in Figure 4. The observations of the three groups follow an expected pattern. Investors see co-op investments as more risky than noninvestors and as having a higher rate of return than both other groups. Agricultural loan officers are slightly more optimistic than noninvestors about the rate of return, but are much more pessimistic about risks.

Summary

Income volatility, increased income, reduced government program payments, economic development environment in the state and successful sugar beet cooperatives created an environment conducive to cooperative development. An external support system is deemed essential by participants in cooperative development. In North Dakota this system consists of organizational catalysts, grant funds for organizational expense, conferences, qualified consultants, and other supporting infrastructure.

Figure 1. Producer Responses Regarding Their Perceived Role in the Agricultural Industry

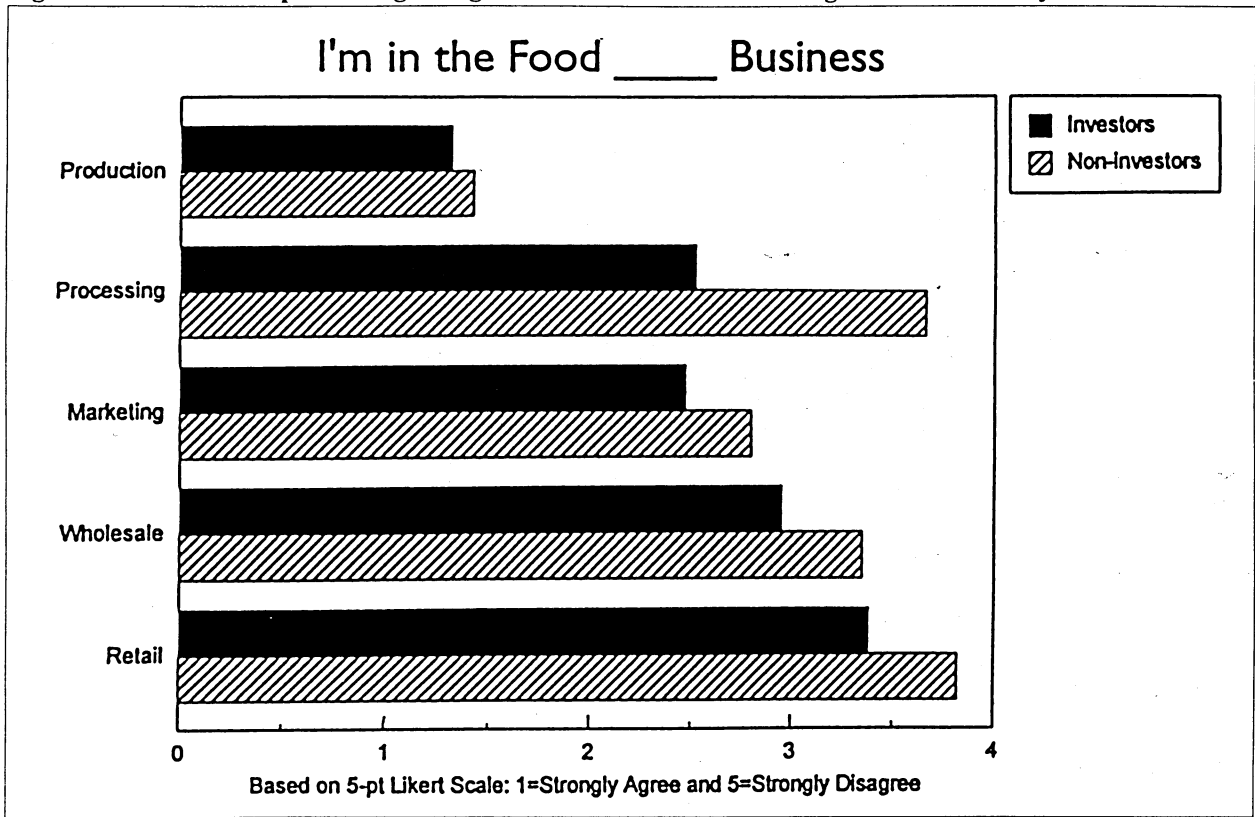


Figure 2. Producer Responses Regarding Frequency With Which New Generation Cooperatives Meet Selected Objectives

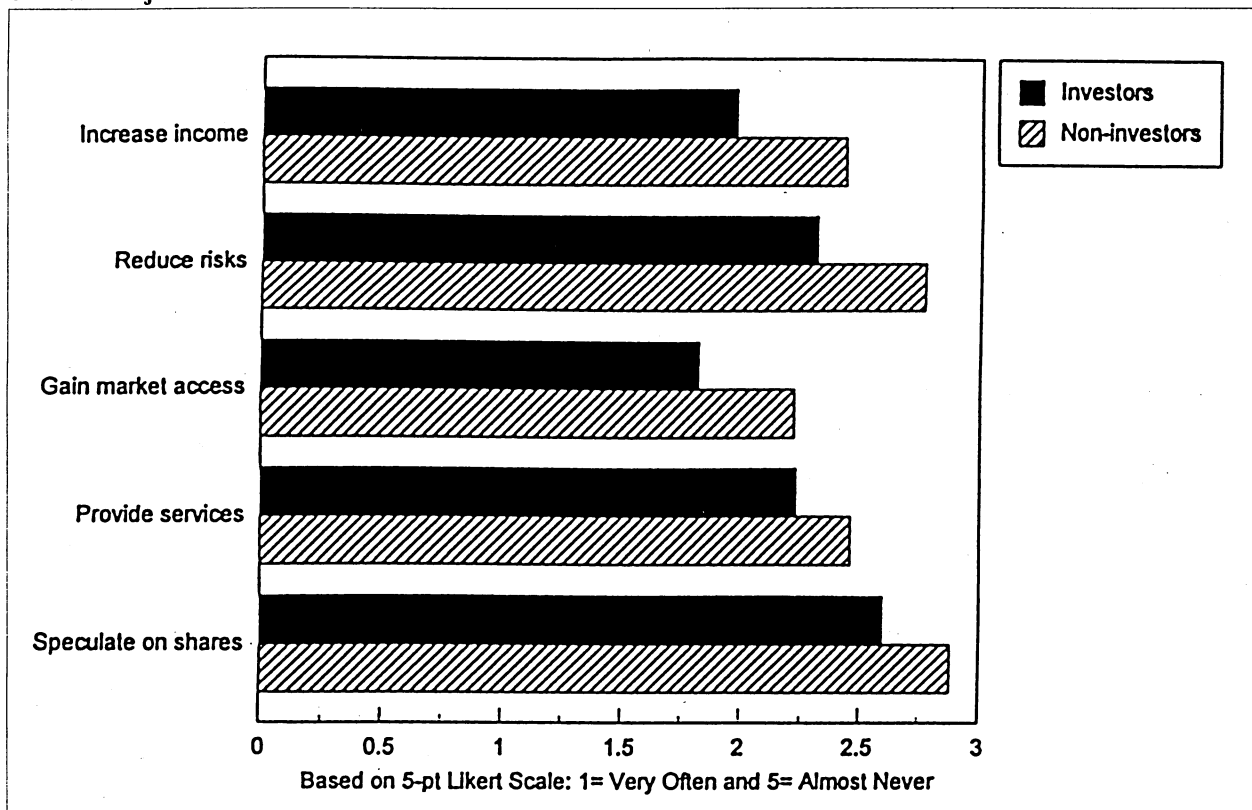


Figure 3. Producer Responses to Negative Comments About New Generation Cooperatives

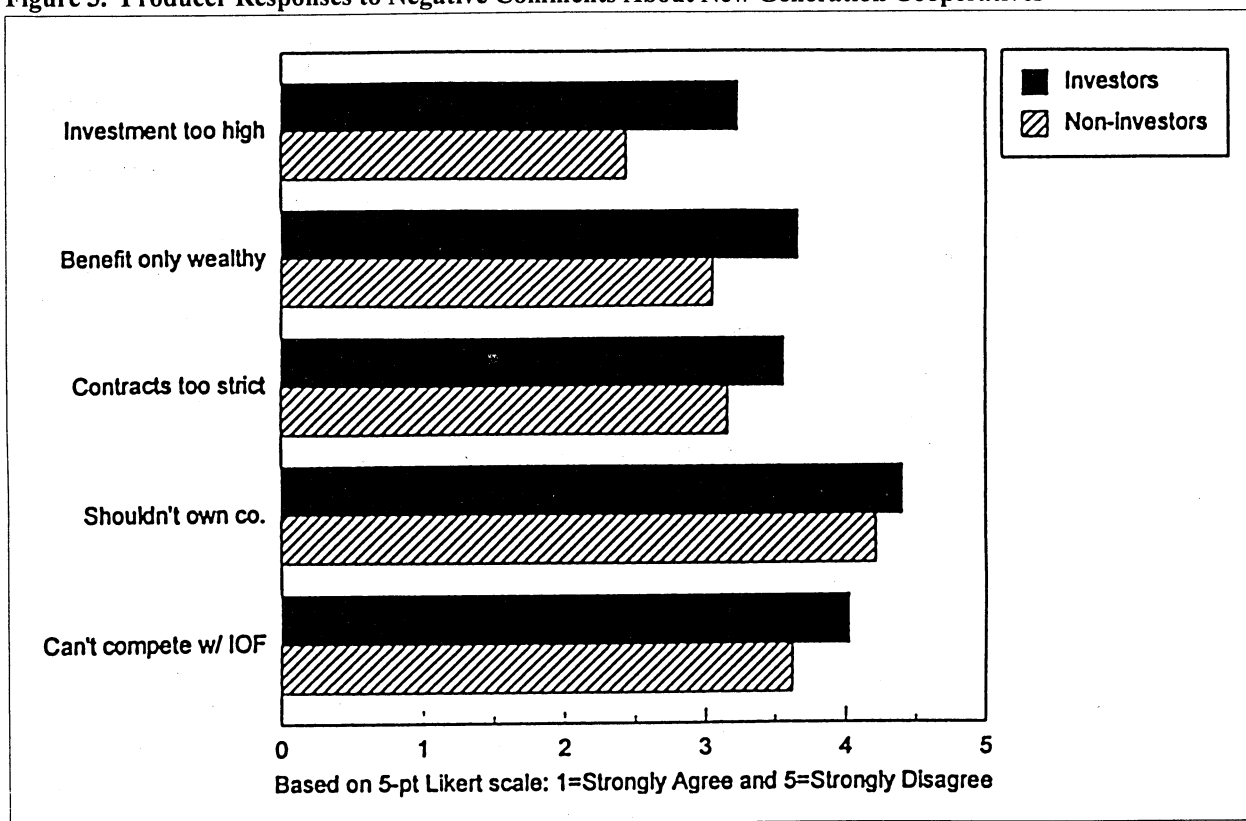
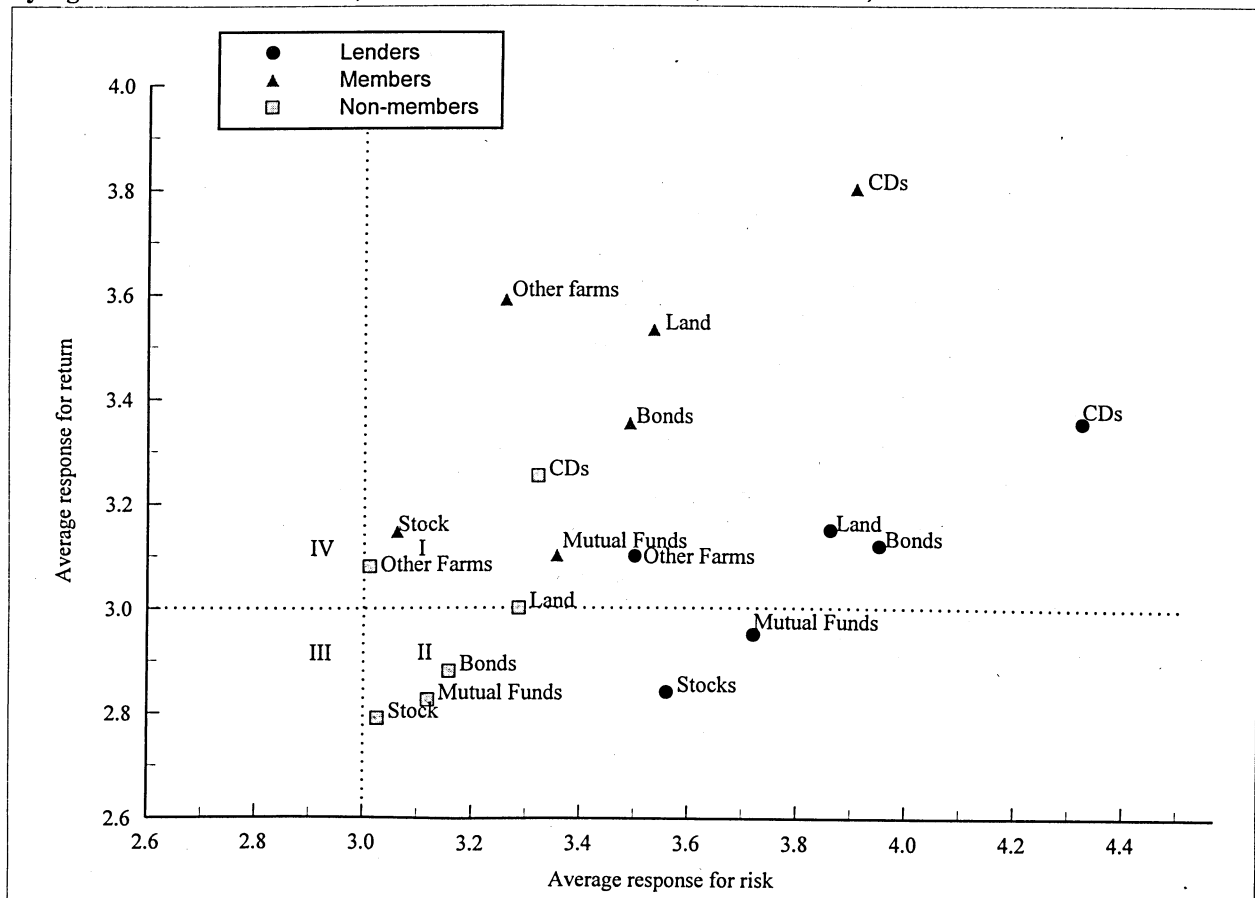


Table 2. Data Collection Questionnaire Regarding Perceived Long-Term Risk and Expected Rate of Return from New Generation Cooperative Investments Compared to Other Investments

How do you think the new value-added cooperatives compare with the following investment alternatives in their long-term return on investment?					
	Much Higher	Somewhat Higher	About the Same	Somewhat Lower	Much Lower
Stocks	5	4	3	2	1
Bonds	5	4	3	2	1
Mutual Funds	5	4	3	2	1
CD's	5	4	3	2	1
Land	5	4	3	2	1
Other Farm Enterprises	5	4	3	2	1
...Long-Term Risk of Investment					
	Much Higher	Somewhat Higher	About the Same	Somewhat Lower	Much Lower
Stocks	5	4	3	2	1

Figure 4. Average Estimate of Risk and Return of Co-Op Investments Compared to Alternative Investments by Agricultural Loan Officers, Members and Non-Members, North Dakota, 1996



Source: Wilson, Goreham, Kibbe and Cobia.

Note: Based on 5-pt Likert scale: 5=Much Higher and 1=Much Lower

Investors in new generation cooperatives, compared to noninvestors, are younger, better educated, have more net worth, view themselves as being in the food processing industry and have a more positive attitude toward new cooperatives.

Notes

David W. Cobia is Professor of Agricultural Economics and Director of the Burdick Center for Cooperatives at North Dakota State University, Fargo.

References

- Agricultural Products Utilization Commission. 1995. *Legislative Report: Biennial Report 1993-1995*. Bismarck, ND. Jan.
- Harris, A., B. Stefanson, and M.E. Fulton. 1996. "New Generation Cooperatives and Cooperative Theory." *J. Coop.* 11:15-18.
- Minnesota Association of Cooperatives. Various. *Year in Cooperatives: A Cooperative Development Magazine*. St. Paul, MN.
- Minnesota Association of Cooperatives. 1995. *Reviving Renville*. A video. St. Paul, MN.
- North Dakota 2000 Committee. 1990. *VISION 2000: An Eight-Point Agenda for Building a New North Dakota*. Fargo, ND, Mar.
- Popper, Frank J. 1984. "Survival of the American Frontier." *Resources [Resources for the Future]* 77 (Summer):1-4.
- Sexton, Richard, and Julie Iskow. 1988. *Factors Critical to the Success or Failure of Emerging Cooperatives*. Giannini Foundation Info. Series 88-3, University of California Dept. of Agr. Econ., Berkeley.
- Wilson, Brooks M., Gary A. Goreham, Theron Kibbe, and David Cobia. 1996. *Agricultural Loan Officers' Roles in Cooperative Investment in North Dakota*. Fargo, ND: North Dakota State University Dept. of Agr. Econ. Rep. 366.