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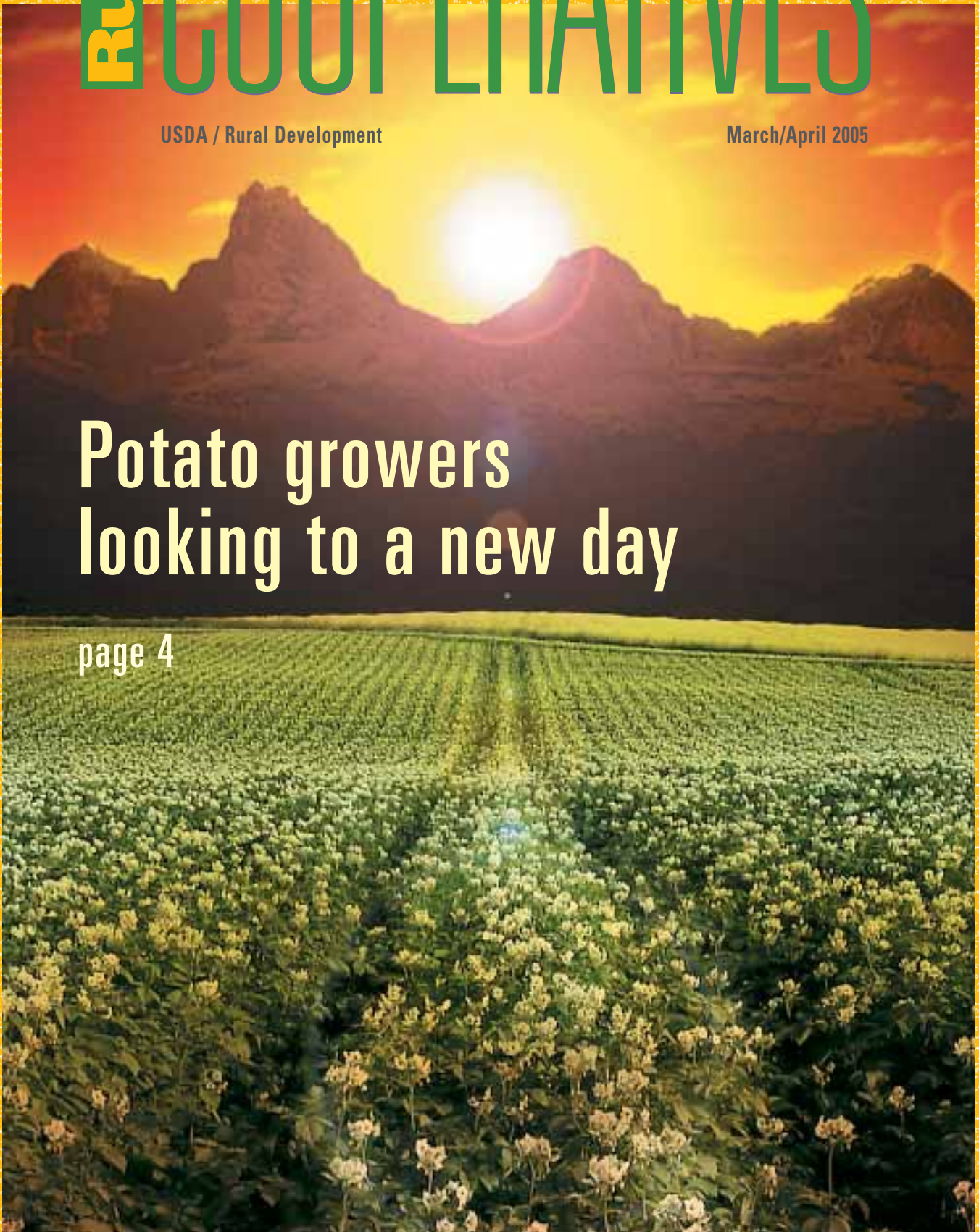
# Rural COOPERATIVES

USDA / Rural Development

March/April 2005

## Potato growers looking to a new day

page 4





## *Producers are natural leaders for rural communities*

*Editor's note: Guest commentary for this issue is by Lynn Jensen, state director for USDA Rural Development in South Dakota. Jensen, past president of the National Corn Growers Assoc., continues to farm at Lake Preston, S.D., population 600, and is an investor in several farmer-owned, value-added enterprises.*

USDA Rural Development isn't crop subsidies. It isn't conservation programs. It doesn't deal with mad cow disease.

Rural Development is investment banking. It's the investment arm of USDA with a focus on economic opportunity and quality of life.

In the first four years of the Bush administration, Rural Development has invested over \$50 billion in rural communities for everything from new value-added, producer-owned businesses to broadband technology. Rural Development brings you electricity and water and it helps build your schools, hospitals and fire stations.

It's the lead federal agency on value-added agriculture and one of the key players on biofuels. It also provides technical assistance, research and education (including this publication) to help build stronger rural cooperatives.

As we continue to transition beyond traditional commodity agriculture, Rural Development will be an increasingly important partner across the board in rural communities.

Business development is a big

*If rural communities are going to work, producers have to get involved. This is about quality of life.*

part of what Rural Development does. The fastest growth rate in rural areas has been in farmer-owned, value-added businesses.

In rural communities, successful producers and co-op members are natural leaders. They have the energy, the business experience, the resources and the respect to lead. If rural communities are going to work, producers have to get involved. This is about quality of life. This is about your sons or daughters coming back home.

We also know there's a cash value to your farms and ranches in having good schools, a grocery store, hospital, implement dealer or fire station within a reasonable distance. None of those things will be there if producers don't get involved. Our communities need you on the school board, the hospital board, etc., but mostly on the local economic development board.

While we work to build stronger rural communities, we also need to continue to transition to more value-added agricultural businesses. The National Corn

Growers Association just issued a new report, "Taking Ownership of Corn Belt Agriculture," which producers need to read.

The report says: "As the business leaders and economic engines of their communities, U.S. farmers and ranchers play a vital role in revitalizing America. They possess the capital reserves needed to invest in new value-added ventures, and the willingness to diversify outside of raw commodity production."

Bio-agriculture is one of a number of emerging technologies with extraordinary potential. It is in its infancy. I can't tell you where it will be in 20 years, but I do believe in 20 years we will be looking back in astonishment at how far we've come.

Producers have some decisions to make. Not everyone will make the same choice. There are real opportunities for producers to participate in the ownership structure.

Ethanol, for example, took off when producers got involved in a big way. Ethanol is becoming a decentralized industry with strong local ownership. We know that has had tremendous benefits for rural communities.

Producers need to be alert to the opportunities that will arise along the way to participate in ownership. That's where the greatest gains will be realized.

— **Lynn Jensen**,  
State Director  
USDA Rural Development,  
South Dakota ■

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## FEATURES & NEWS



p. 4

**4** *Price crisis prompts potato growers to form national co-op*



p. 8

**8** *Low-carb, High Hopes*

*Co-op's tubers may beef-up Florida's potato industry*

**11** *Farmer co-op business volume nears \$117 billion*

**14** *Unflappable*

*Plant closure forces co-op launch onto fast-track*



p. 14

**18** *A Perfect Storm*

*Farmland trustee sues ex-officers, directors*

**23** *Court of Preference*

*Minn. co-op helps manufactured home residents*

**25** *Upswing Continues*

*Despite loss of Farmland, Agway, revenue & income climb for top 100 co-ops*



p. 18

**30** *Perils & Pleasures of Partnerships*

*Key issue of co-ops in business partnerships: Who do you trust?*

## DEPARTMENTS

- 2 COMMENTARY
- 12 VALUE-ADDED CORNER
- 24 LEGAL CORNER
- 33 NEWSLINE
- 43 INSIDE RURAL DEVELOPMENT

### On the Cover:

Potato growers in Idaho and other states are hoping they can establish a fair price for their crop through a new co-op that will work to better balance supply and demand. In Florida, another new co-op hopes to find success with a low-carb potato variety. Articles on pages 4 & 8. Photo courtesy United Fresh Potato Growers of America



# Price crisis prompts potato growers to form national cooperative

By **Stephen A. Thompson**  
Assistant Editor

**P**otatoes have been a staple of the American diet for more than a century, and U.S. and Canadian growers together produce about 18.5 million tons of them a year. For many Americans, a meal just isn't complete without potatoes, whether mashed, fried, boiled, or baked. However, recent trends in consumption and increases in growers' productivity are keeping potato prices down, putting farmers in a bind. In response, a nation-wide cooperative is being formed with the purpose of better managing supplies to help growers earn a fair price.

United Fresh Potato Growers of America was organized March 3, in Washington D.C., during the annual meeting of the National Potato Council. United of America hopes to become an umbrella organization for a network of state co-ops that will monitor the potato market and encourage farmers to take voluntary action to limit potato production when required to keep prices at, or above, a break-even level.

Until recently, the amount of potatoes people eat each year was rising: the total weight of potatoes eaten in the United States per person is about 30 percent higher now than it was in 1980. But the popularity of the "low-carbohydrate" diet and other trends have put the squeeze on fresh potato consumption: in 2002, annual U.S. per capita consumption dropped more than 10 percent from its peak in





1993, according to USDA's Economic Research Service.

Part of the problem is the growing proportion of people who live in one- or two-person households. People who live in families with children are the greatest consumers of potatoes. Reduced demand for French fries in fast-food restaurants is another factor. But the most conspicuous cause is the rise of the "Atkins Diet" and its imitators. Such diets require people to consume drastically reduced amounts of carbohydrates.

In its first phase, the Atkins Diet requires consumption of only 20 grams of "carbs" per day. Normal carbohydrate intake in the United States, according to the Institute of Medicine, is about 200 to 330 grams per day for men, and 180 to 230 grams for women. The average potato contains about 26 grams.

Whatever the causes of the slump in potato demand, the impact on prices has been dramatic. Bulk prices for fresh potatoes now hover around the \$2-per-hundredweight mark — \$2.50 below the price producers say they need to stay in business.

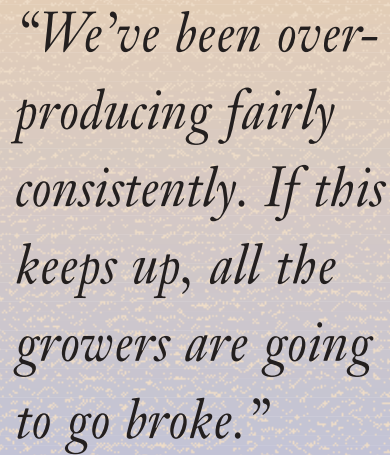
### Responding to a crisis

In response to the low-price crisis, Florida farmers have come up with a low-carb potato they hope will find its own market (see related article, page 8). But northern potato producers will be unable to grow the low-carb variety. They need a different strategy, and they need it soon.

Idaho is the largest potato-growing state, producing a third of the country's crop, and Albert Wada is the largest potato farmer in the state. He grows more than a billion spuds annually on 12,000 acres near Blackfoot, the self-styled "Potato Capital of the World." Wada's father began the operation after he moved to Idaho from California to avoid the federal government's internment of Japanese-Americans during World War II.

Wada says that potato farmers are losing money steadily, watching the equity they have built up in their businesses over many years go down the

drain. He believes the problem isn't just lowered demand. "We've been over-producing fairly consistently," he says. "If this keeps up, all the growers are going to go broke." Other Idaho



*"We've been over-producing fairly consistently. If this keeps up, all the growers are going to go broke."*

*—Albert Wada*

farmers point out that, while Idaho potatoes used to be a recognized "brand," and commanded higher prices than others, that advantage has now lapsed, exacerbating the price problem for Idaho farmers.

"We've operated on the assumption that with free enterprise, hard work, and good weather we'll do okay," says Wada. "But the other side of that coin is globalization of the market."

The advent of the North American Free Trade Agreement (NAFTA), which opened U.S. borders to the import of farm products from Canada and other countries, has put a heavy downward pressure on the prices American farmers can get for their potatoes. "Historically, we would get two years out of five that we made decent money," Doug Hanks, president of the Potato Growers of Idaho, says. The two good years would get the farmers comfortably through the three bad years. But in the last decade, under NAFTA, he says, "It's more like two out of ten."

The problem of foreign competition hit home for Idaho farmers in

2003, when a large French-fry processing plant in Canada began production — replacing one in Idaho — and the United States became a net importer of French fries. The announcement of the Idaho plant's closing had come after the 2002 crop was already planted, resulting in a large surplus of potatoes in the state.

In 2003, despite voluntary acreage reductions, farmers realized an even larger surplus. The resulting low prices have affected potato prices across the country.

### Co-op role in supply management

Wada thinks the answer lies in managing the supply of fresh potatoes. He founded United Fresh Potato Growers of Idaho in late 2003, hoping it would form the nucleus for a nationwide federated cooperative with member co-ops in each potato-producing state. The idea, he says, is to unite potato growers and "rationalize the industry," by tailoring production to the market, much the same way milk producers have managed to do with dairy production. The plan is called United We Stand (see sidebar).

Attorney Randon Wilson, legal counsel for the co-op, stresses the need for the effort to conform to the Capper-Volstead Act so as not to be subject to anti-trust laws. That means that packers and other ineligible businesses can't participate. "We've got to be a pure farmer's cooperative," he says.

With the formal organization of the national federated cooperative this March, the effort is underway. Representatives of state and regional potato-grower associations and cooperatives voted Albert Wada the interim chairman, and pledged to help set up the state and regional co-ops that will form the foundation for United Fresh Potato Growers of America.

The effort will face a number of challenges. The first is the necessity of getting enough producers on board to be effective. Not only must a high proportion of growers join, but the co-op

must represent all the major potato-growing states. “We need to get participation from all the significant growing areas,” says Wilson. “If we don’t, it’s curtains for this deal.”

Potato farmers tend to prize independence, and don’t have the same kind of strong cooperative tradition that helped the organizers of the CWT program in the dairy industry (See Newsline, page 33). But Wada and David Beesley, the secretary of United of Idaho, say that the beauty of their program is that it preserves farmer autonomy.

Producers will still sell their crop to whomever they wish, for terms agreed between buyer and seller. And as long as prices remain above the trigger point, the program will take no action. Should

supply reduction be necessary, participation in buyouts of acreage or crops would be entirely voluntary. A farmer with formal or informal obligations to sell his full output to buyers would still be able to do so; others with comparatively more incentive to reduce production would bid to reduce their own.

“One thing we want to be careful about is how we treat our customers,” said one farmer at the organizational meeting. “And this program will allow us to treat them with respect and preserve our good relationships with them.”

### **Two approaches to Supply management**

“There are two basic approaches to dealing as an industry with oversup-

ply,” says attorney Wilson. “One is to seek a government program, such as marketing orders or subsidies. The other is for the industry to take the initiative to unite and pursue programs of mutual benefit.” Many farmers are very reluctant to seek a government marketing program or other assistance, for fear it will compromise their independence, he says. “Often, federal programs mandate participation. But the beauty of an industry program like this is that it leaves growers free to make their own decisions.”

Some experts wonder if large buyers such as Wal-Mart and the large supermarket chains will balk at attempts to raise prices, and seek alternative sources. But Beesley says that, for the most part, the large customers would



*Representatives of potato-growers associations vote to establish United Fresh Potato Growers of America during a March meeting in Washington, D.C. Albert Wada, appointed interim chairman, is at center left in the white shirt. USDA photo by Steve Thompson*



like to see a stable price situation. "They can't plan ahead with prices going up and down the way they do now," he says.

One possible stumbling block is the cost of participation. Member farmers, many already strapped for cash, will be required to help fund cooperative administrative programs. In addition, co-op funds may be used to offer incentives for switching acreage to other crops, and, if necessary, to buy out portions of a crop after harvest. Under the dairy farmers' CWT program, farmers pay into an indemnity fund, through an assessment on projected output, for this purpose. However, no decision had been made at press time about implementation of such a program.

The cost of such an indemnity fund should be seen as a highly

attractive investment, says Carl Taylor, chairman of United of Idaho's Future Crop Committee, who hammered out the basic United We Stand plan. "If you pay in 40 cents a hundredweight, but in return you get a price for your crop of \$4.50 instead of \$2, you've just made a profit of over 1,100 percent."

This strategy assumes that buying out acreage and harvested potatoes will be cost-effective. The co-op cites research by the University of Idaho indicating that a 1-percent decrease in fresh potato supply can be leveraged into a 7-percent rise in prices. The ultimate return will depend on the prices farmers are willing to take for reducing their crops and other market factors – most especially how many farmers decide to participate in the co-op.

Will enough potato farmers sign up

to make the plan work? "We've tried to get something like this going before," says Doug Hanks, "But we couldn't reach critical mass." However, he says, "Now the willingness to do something is at 'must' level for growers in Idaho and across the country, because of continued low returns they're getting for fresh potatoes."

Potato farmers at the National Potato Council conference expressed varying degrees of hope and skepticism. "I don't know if it'll work, but we need to do something," said one. Most, however, seemed cautiously hopeful.

Wilson is enthusiastic about the co-op's chances. "I have high hopes the farmers will deal with this problem as an industry, that they will work together to bring the supply of potatoes into line with the demand. That's the name of the game." ■

## The United We Stand program

United Fresh Potato Growers of America envisions a two-pronged approach to influencing the market, similar to the successful Cooperatives Working Together (CWT) program that has helped shore up milk prices by removing some excess milk capacity (see page 33).

The first prong is the withdrawal of a calculated amount of productive acreage. If acreage restrictions fail to result in sufficient upward pressure on prices, the second prong calls for restricting the number of potatoes harvested.

To limited planted acreage, a base acreage will be defined using historical information verified by USDA's Farm Service Agency (FSA). Planting commitments by farmers will be gathered every year by Feb. 28, and the co-op will perform a comprehensive demand/supply analysis, considering such factors as potential yields, projected market demand, etc.

If the market analysis indicates that the projected crop will be too large, the cooperative will offer to pay farmers for retiring potato-producing acreage. Farmers will bid to plant alternative crops for a chosen price per acre. Factors to be taken into consideration for bids will be the location of the farm, its potential productivity, the varieties of potatoes grown and, of course, the price the farmer agrees to accept. Co-op

officials pledge that all information provided by producers will be held in strictest confidence.

Farmers or their agents would take part in frequent conference calls throughout the year discussing prices and expected output in their respective areas.

The June 1 potato planting report, issued by USDA's National Agricultural Statistics Service, will serve as a possible warning bell for a potential surplus. Using the latest information, the co-op will perform another demand/supply analysis, and determine if growers should be encouraged to voluntarily limit production by minimizing inputs on selected acreage.

Another analysis will be done Aug. 15. If projected yields are not compatible with favorable prices in the projected market, the co-op may ask farmers to destroy a portion of the crop in the field. If low price conditions arose after the harvest, measures would be taken to limit shipments of potatoes until prices rise to a reasonable level. Other potential supply-management tools include a "B market" strategy that would divert potatoes to export and to non-conventional uses such as animal feed.

To head off potentially disastrous prices in the coming year, the cooperative is also attempting to institute a crash crop-acreage buydown for the 2005 potato planting. ■



# Low-carb, High Hopes

*Co-op's slimmed-down, SunLite tubers may beef-up Florida's potato industry*

**By Ellen Boukari**

USDA Rural Development/ Florida Public Affairs Office

**B**ursting with calcium, niacin, iron and Vitamin C, potatoes are one of the world's great foods. Even potato skins are a good source of fiber. And they can be served in a seemingly infinite number of ways. It's not surprising, then, that potatoes have long been America's most popular vegetable, according to USDA's Economic Research Service, which reports that the typical American consumes more than 140 pounds of spuds each year.

But for weight-conscious consumers, there is trouble lurking beneath the skin: carbohydrates, and

plenty of them. If you subscribe to the notion that fat is the dieter's friend, carbohydrates — as are found in bread and potatoes — are viewed as dietary offenders. As the low-carb diet trend has taken root, millions of Americans have adopted a low-carbohydrate regimen. That's resulted in the sale of a lot of meat, but fewer potatoes.

Potato sales have been declining precipitously in the Tri-County agricultural area (St. Johns, Putnam and Flagler counties) of northeast Florida, once known as the Potato Capital of Florida. The number of potato growers here has dwindled from nearly 400 farmers in the early 1970s to fewer than 40 today.

## **Fighting to regain crown**

Five Florida potato growers are seeking to regain lost market share by

forming SunFresh of Florida Marketing Cooperative Inc. The members, all sixth-generation Florida potato growers, think that a new variety of low-carb potatoes they are growing can even help the Tri-County area regain its potato crown. The co-op has been bolstered by technical assistance and a \$95,000 Rural Business Enterprise Grant (RBEG) from USDA Rural Development. Also playing a vital role is Chad Hutchinson, an assistant professor of horticulture at the University of Florida's (UF) Institute of Food and Agricultural Sciences.

Hutchinson has been growing and testing the new potato variety for five years at UF's Plant Science Research Unit in Hastings, Fla. In 2000, potato farmers and UF scientists began working with Dutch seed company HZPC to develop a better potato — better

*Checking on the first crop of low-carb potatoes (from left) are: Edsel Reddon, University of Florida extension agent; USDA Rural Development State Director Charles W. Clemons; and Wayne Smith, president of Sun Fresh of Florida growers' cooperative. USDA photos by Ellen Boukari*



*SunLite low-carb potatoes are sorted at the co-op's packing house.*

tasting, better looking and with an increased shelf life. It has 30 percent fewer carbs and higher protein than russet potatoes (the biggest selling variety in the United States). This tuber innovation is already impressing health-conscious consumers and is bringing the potato back to the dinner tables of more people on low-carb diets.

“Growers love this potato,” says Hutchinson. “It is disease resistant, has a shorter growing cycle and is better able to deal with Florida’s extreme weather.”

Co-op growers are hopeful that the new SunLite potato will revive the potato market *and* turn a profit for them. Joe Mueller, business and cooperative programs director for USDA Rural Development in Florida, provided the co-op with critical help in developing their marketing organization. The RBEG funds from USDA assisted with the initial marketing rollout for the new potato.

The SunFresh co-op has exclusive rights to the potato. As an added benefit, SunLite low-carb potatoes are grown in compliance with a pilot USDA program that provides identity preservation of the crop from the farm

to the consumer. Shoppers are thus assured they are getting authentic SunLite™ low-carb potatoes.

#### **Trouble in potato country**

While growers are optimistic about the new potato, they also are aware that competition from northern growers will remain tough. The Tri-County potato-growing region consists of about 21,000 acres of unique farmland. The moderate climate allows growers to harvest potatoes early in the year, usually in March and April, sometimes even earlier. Over the years, Mother Nature’s benevolence was a boon to Florida growers, giving them the competitive advantage over cold-weather spud growers.

However, due to new potato storage technology and excess potato production in northern states, growers here can no longer compete by relying solely on the early-to-market growing cycle and the freshness of their product. The number of buyers has dwindled, also contributing to the decline of the Florida potato industry. With little member commitment, another local co-op was not having much luck increasing prices or finding new mar-

kets for its members, Mueller notes.

By 2003, Florida’s potato industry was ripe for a positive change. The ground-breaking, low-carb potato was the impetus needed to rally the farmers into a unified group seeking a bigger market presence.

Prior to the formation of SunFresh, there has been little crop differentiation in Florida potatoes had none had a brand identity. Potato marketing has historically been focused on bulk production, with most sales made to manufacturers of the potato chips or French fries. Farmers knew that in order for the low-carb potato to be a success, they would need more than a better potato.

The task was formidable.

Instead of focusing solely on growing and harvesting potatoes, the farmers now were tasked with product management, from planting to harvesting, packing, shipping and marketing on a national scale. Seeking advice about how best to bring to fruition the many pieces of the challenging puzzle, farmers and scientists consulted with local agriculture extension agent Edsel Reddon, who in turn called on Mueller at USDA Rural Development for advice.



### Co-op: perfect marketing vehicle

While Florida's potatoes represent only 5 percent of the nation's crop, they are important to the state, generating more than \$120 million in sales annually.

Mueller was convinced that if farmers worked together and had a strategic plan for the future, they could capture more profits with the low-carb potato. The co-op seemed to be the perfect vehicle to take this new potato to the market place.

But given the lackluster performance history of some other cooperatives in the area, it was no easy task to convince growers that a new co-op was the best bet toward making the low-carb potato profitable. Organizing and operating a new co-op would be the true test of commitment and dedication.

Less than 12 months after it was launched, Mueller says SunFresh of Florida Marketing Cooperative "has demonstrated a winning combination of know-how, determination and management skills to handle the myriad of details required, both internally as well as externally.

### Marketing campaign

The cooperative is pushing full-steam ahead with marketing strategies that emphasize the potato's health benefits. Sunfresh is promoting the SunLite brand as a unique, gourmet potato sure to please the palate and the waistline. The growers also want to market the potato as a fresh vegetable with a brand name and logo, so that shoppers will ask for it in their grocery store.

Given that the potato is smooth skinned, has small eyes and slightly yellow flesh, it offers eye appeal and tempts the tastebuds with its fresh creamy texture. And butter and sour cream are optional, due in part to the potato's high-moisture content, says Hutchinson.

USDA Rural Development's RBEG funding was provided to the Floridan Resource Conservation and Development Council, which in turn used the funds to assist the co-op in marshalling

marketing activities for the potato. A marketing campaign targeting wholesalers, retailers, the food service trade and consumers is in full swing to market SunLite as a premium table potato.

The potatoes hit supermarket shelves in February 2005 as "SunLite All Natural-Low Carb Potatoes." Sunfresh began its marketing campaign by targeting grocery stores in the southeast, including regional and national chains. With marketing assistance from the Florida Department of Agriculture and Consumer Services (FDACS), each bag of SunLite low-



*SunLite potatoes are bagged at the co-op's packing house. Three-pound bags were fetching \$4 in some stores in March.*

carb potatoes brandishes appealing labeling and an eye-catching logo. The marketing strategy is "to sell the sizzle and not the steak," says Sunfresh Cooperative president and "SunLite" potato farmer Wayne Smith.

Over the past eight months, the low-carb potato has been featured in numerous publications, including coverage on major newswires and network television. Smith said that spending time with reporters and photographers has become somewhat commonplace for him.

### Looking ahead

Currently, all grading, packing and shipping is done in the co-op's St.

Augustine facility. The first year's production of the new variety will come from an estimated 4,000 acres and will triple in the second year, according to Smith. As many as 30,000 acres are projected to be in Sunlite production in three years.

SunFresh cooperative growers also have planted SunLites near Immokalee in south Florida. Flexibility in harvesting and shipping is a distinct advantage as the market moves from the south to the north. And, with multiple growing locations, co-op members believe they are better protected against bad weather, which has besieged Florida growers in recent years.

Smith says that Sunfresh will add additional producer members as demand for the innovative tuber exceeds current member's capacity. There will also be a need to add production during times when Florida growers have no potatoes to sell. The co-op's five-year plan calls for spreading production to 10 states and developing six packing and distribution facilities.

If there is a downside to marketing SunLite as a premium table potato, it is the larger percentage of culls — potatoes that don't pass visual appearance standards. Although culls, or "No. 2s," are identical in nutritional value to their more visually appealing counterparts, even small surface blemishes result in downgrading. This has spurred the co-op to look into additional markets, such as the school lunch system. As production increases, additional possibilities include a variety of frozen packaged potato products.

The future of Florida's potato farmers is looking brighter these days, and as USDA Rural Development State Director Charles W. Clemons Sr. said at a press conference last summer: "Not only will the low-carb potato bring desirable options to the American consumer, it will energize Florida's potato industry with increased market share." And that's no small potatoes for Florida's \$120 million industry. ■

# Farmer co-op business volume nears \$117 billion

*Editor's note: Information for this article was compiled by the Statistics Staff of USDA's Rural Business-Cooperative Service, including Celestine C. Adams, Katherine C. DeVille, Jacqueline E. Penn and E. Eldon Eversull.*

**F**armer-owned cooperatives had gross sales of nearly \$117 billion in 2003, up 4.4 percent from \$112 billion in 2002. Increases in crop and livestock production helped boost total sales, more than offsetting the effect of the bankruptcies of two large cooperatives.

Total co-op farm marketing (which includes the sale of all crops, livestock and value-added goods) climbed 4 percent, farm supply sales increased 7.5 percent and receipts from farm services were up marginally (table 1), according to an annual survey conducted by the Cooperative Services office of USDA Rural Development.

Income (before taxes) for all U.S. farmer cooperatives was \$1.4 billion in 2003, up from \$1.2 billion in 2002.

Overall, cooperatives saw higher levels of equity capital on their balance sheets, but it still remains low, averaging 42 percent of all assets. Cooperative assets increased 1 percent, liabilities remained about the same and equity increased about 2 percent (figure 2).

The bankruptcies of the federated co-ops mentioned above resulted in drastically lower patronage refund income for local farmer cooperatives, which fell by 78 percent. As a result, many cooperatives experienced a write-down in their equity accounts. Overall, net income before taxes

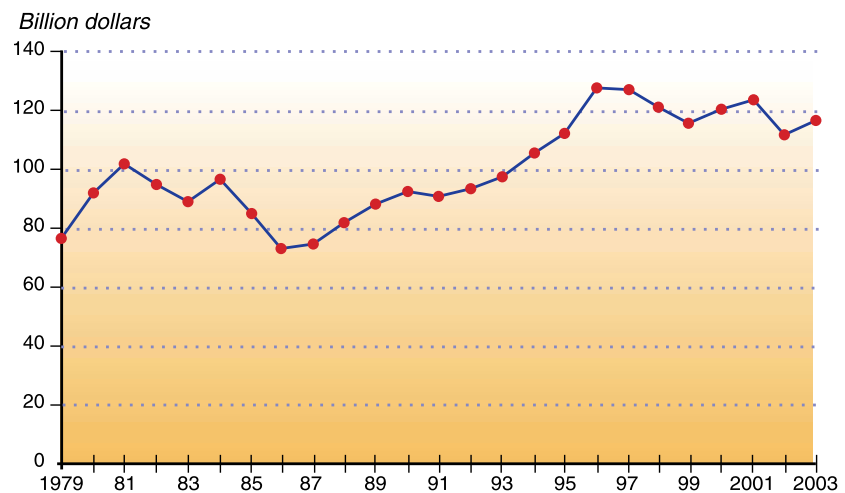
increased by almost 18 percent, even with lower patronage income.

Farmer cooperatives remain one of the largest employers in many rural communities, with overall employment increasing by 1 percent, to 223,000 in

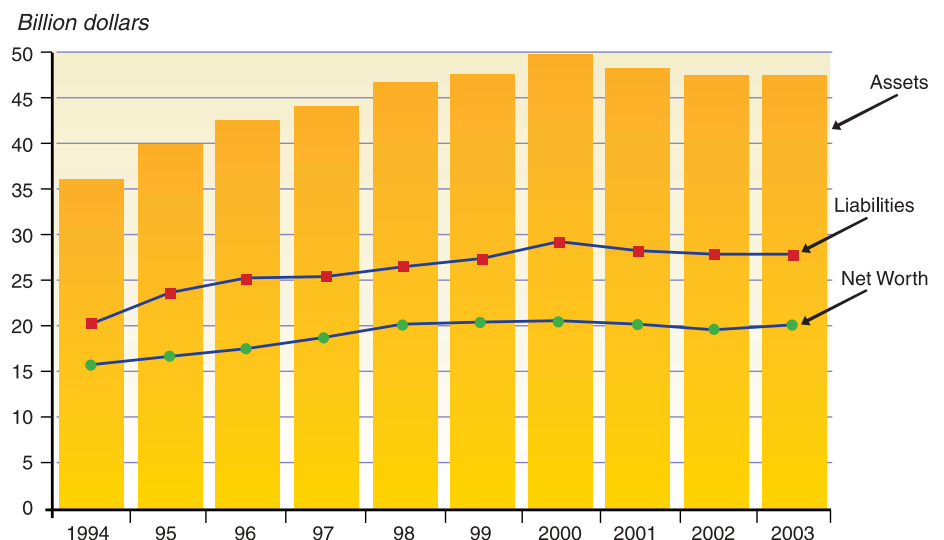
2003. Full-time employee numbers declined by almost 2 percent, to 164,000, while part-time and seasonal employees increased almost 10 percent, to 59,000.

*continued on page 39*

**Figure 1—Cooperatives' Gross Business Volume**



**Figure 2—Cooperatives' Assets, Liabilities, and Net Worth**







# Trading on Tradition

*Heartland Farm Foods uses country tradition to market members' beef*



**By Erica Coble**

*Editor's note: Coble grew up on her family's beef cattle and alfalfa hay farm in the southwest Missouri town of Dadeville. She is a senior majoring in ag journalism, with a minor in ag economics, at the University of Missouri-Columbia.*

**A** consumer walks into a grocery store looking for a meat product that's easy to prepare, stores conveniently and is safe for her family. Walking down the canned food aisle, the consumer spots a product she's never seen before. There on the shelf, wrapped in a red label, is Heartland Farm Foods' fully cooked ground and chunked beef. Curious, the consumer picks up the can and turns it around to look at the ingredients; only one is listed: beef. In addition, the beef is hormone-free, has no preservatives, salt or other additives and can be traced back to the farm where it was raised.

Heartland Farm Foods LLC, a subsidiary of the Farm Foods Cooperative, was formed in 2001 by 39 east-central Missouri farm families. Headquartered in Montgomery City, Mo., the cooperative uses family home-canning recipes to produce high-quality canned ground and chunked beef. The shelf-stable product is all-

natural and contains only beef.

Canning food is, of course, a traditional food-preservation technique used by Americans for generations. It remained popular longer in rural areas, especially where electricity for refrigeration was slow in coming. Irene Edwards of Montgomery City had been canning beef for years and giving it away in glass jars. People loved the flavor and the convenience. The family gradually realized there might be a business opportunity in those jars.

After a study showed market potential for the product, the Edwards family shared the plan with their neighbors and decided to pursue a value-added business venture. The goal: provide consumers with a convenient, tasty, high-quality beef product while creating a new business channel that would help farm families realize more profits from their cattle.

Since the initial introduction of two canned-beef products, the co-op and its LLC subsidiary have been working to build brand recognition and to get their product on the shelf. Four years after the launch, the cooperative has its own canning facility that employs five full-time employees and is set to introduce new products this spring.

## Shares prove popular

Forming cooperatives can be an attractive idea for producers, but the farmers involved in Heartland Farm Foods will tell you that it is not an easy venture to undertake. Building a successful business takes hard work and patience. The first organizational meeting was held in December 2000, a steering committee was formed in early 2001 and the business was organized as a new-generation cooperative in December of 2001.

Once the steering committee was formed, the group set out to create the governing rules and elect a temporary board. "The steering committee went through a lot of challenging times,"

says Adam Blau, a Missouri beef producer from Wellsville and board chairman of the Farm Foods Cooperative. "It's always an interesting process when you get a group of six to eight farmers together who all have different experiences and strong opin-



ions on how a business should work.”

The group initially incorporated as Farm Foods Inc. As they progressed towards becoming a value-added enterprise, they were advised by legal counsel to form an LLC to address liability concerns. This resulted in the creation of the co-op’s wholly owned subsidiary, Heartland Farm Foods.

In February 2002, the temporary board started selling memberships on a per cattle basis. The initial goal was to secure 1,000 cattle per year, with members required to commit a minimum of 10 and a maximum of 50 head of cattle. Each share sold for \$200 and represented a commitment by the member to deliver one head of cattle per year.

It didn’t take long for the idea to catch on. In just two weeks, 90 percent of the memberships were sold; within a month all were sold.

Membership was extended to 39 farm families in Montgomery, Audrain, Pike, Lincoln and Warren counties.

The goal of the first phase of the plan was to get the business moving as soon as possible, so a decision was made to keep membership under 40.

#### **Key help from USDA, Extension**

Assistance has come from a number of sources. Jim Foster, vice president of the board, says that Gary Hoette, a local University of Missouri extension agent, played a key role in helping organize the cooperative. “Gary had helped in getting an ethanol cooperative started, so he had been there and knew how to advise us on things that could have been potentially disastrous for us,” Foster says. Hoette now serves as the co-op’s at-large board member.

The business received additional help from Chris Cobb with the University of Missouri Extension office. She advises and assists the cooperative on a variety of issues.

Business and financial support from USDA Rural Development and the Missouri Department of Agriculture was instrumental in getting the resources the group needed to get their business started. Farm Foods Co-op Inc. received a \$200,000 Value-

Added Producer Grant (VAPG) from USDA Rural Development in 2002.

Funds were used for working capital to support the start-up operations of the hormone, steroid- and antibiotic-free beef canning operation. These funds were matched with the co-op’s investment and \$118,000 in grant funds from the Missouri Department

*The co-op has three main goals: (1) supply a high-quality product; (2) be a positive influence and support the community; (3) create a consistent, profitable market for member cattle and create a future for the next generation of beef farmers.*

of Agriculture for a feasibility study and a business plan.

“We were very excited that Family Farms Co-op could benefit from the VAPG program, which had to compete with 712 applications requesting over \$121 million when only \$33 million was available in 2002,” says Nathan Chitwood, business and community specialist for USDA Rural Development in Missouri. “Their proposal was well written and complied fully with the intent of the VAPG program.”

Heartland Farm Foods was awarded

a second VAPG grant of \$150,000 in the fall of 2004. “Rural Development believes that providing funds to help farmers and ranchers launch value-added businesses such as this project is vital to the future of the nation’s agriculture economy,” says Greg Branum, Missouri state director for USDA Rural Development.

#### **Strong manager essential**

The membership drive netted \$200,000 to go toward building the processing plant. An anonymous donation helped pay for the rest of the \$425,000 in construction costs. The groundbreaking ceremony was held March 21, 2003, where Farm Foods Cooperative owns a 10-acre lot.

From the beginning, the board set three main goals for the cooperative: (1) supply a high-quality product to consumers; (2) be a positive influence and support the community, and (3) create a consistent, profitable market for member cattle and create a future for the next generation of beef farmers.

Members knew that an experienced general manager to move their ideas and vision forward was vital to their success. In October 2002, the board hired Mark Uthlaut, who has an extensive agricultural background. He was a farm manager at Iowa State University, has marketed wool products for a cooperative marketing group and worked in retailing farm meats.

“Mark has been a big factor in taking us where we need to go,” says Blaue. “He went through a USDA required processing school and through Hazard Analysis Critical Control Point (HACCP) certification in Nebraska.”

#### **Traceability reassures consumers**

From the beginning, members wanted consumers to know that the co-op’s producers take good care of their animals, which helps ensure that they get a safe, high-quality beef product.

“The main selling point of our product is that it is born, raised and processed in the USA,” says Foster. “With all of the concerns about food

*continued on page 38*



# Unflappable

*Plant closure forces Virginia poultry cooperative launch onto fast-track*

**By Paul Darby, Southern States  
Cooperative Development Foundation**

*Editor's note: Bill Brockhouse, a co-op development specialist with USDA Rural Development in Washington, D.C., also contributed to this article.*

**D**etermination is “the act of deciding definitely or firmly,” according to Webster’s Dictionary. In the world of cooperative development, determination can be defined as having “fire in the belly.” The Shenandoah Valley-area poultry growers who formed the Virginia Poultry Growers Cooperative (VPGC) possess plenty of each attribute; otherwise, they could never have launched their business under such intense pressure and in such a time frame.

In the Harrisonburg, Va.-area, if you mention the names of Sonny Meyerhoeffer Jr., the co-op’s first president, Steve Long, its vice chairman, or those of a half-dozen other turkey growers who helped lead the co-op’s organizational drive, people will tell you these individuals refused to buckle in the face of unbelievable obstacles and challenges. They stood tall when the heat was on. As a result of their determi-

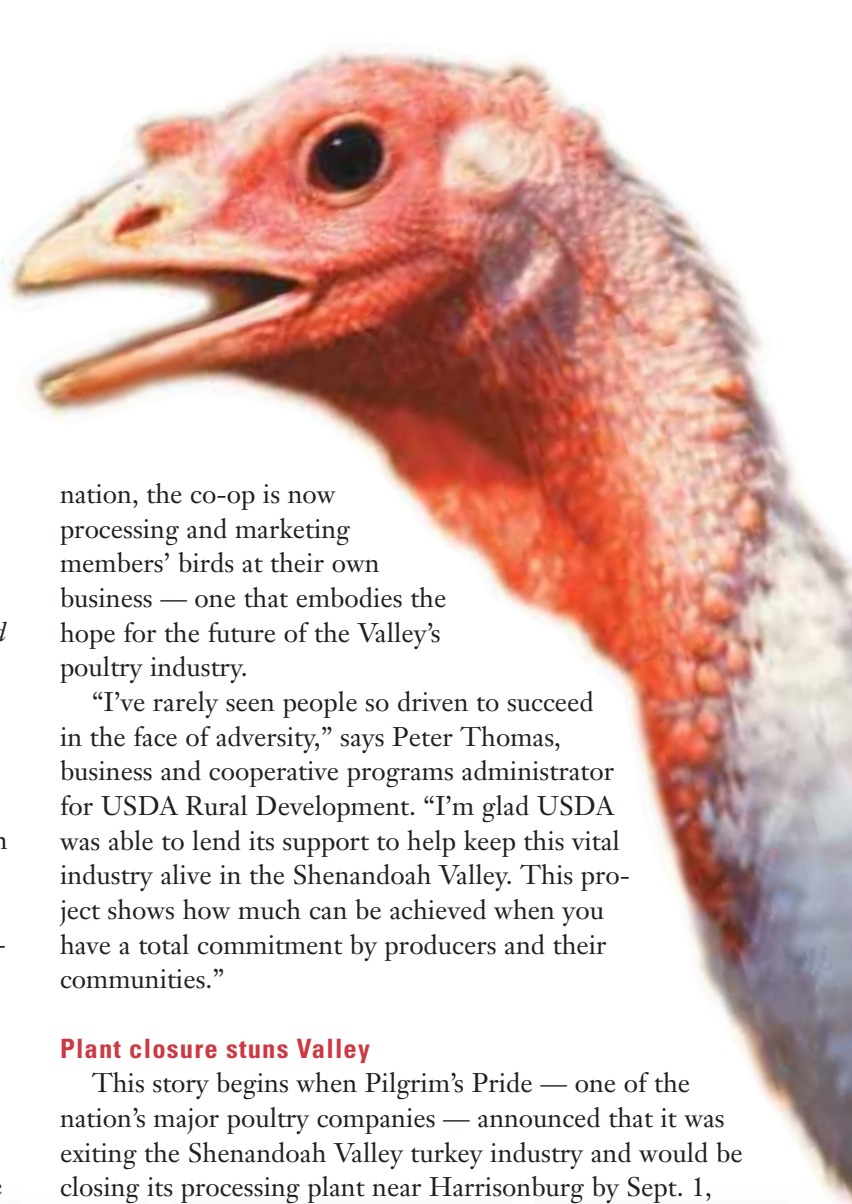
nation, the co-op is now processing and marketing members’ birds at their own business — one that embodies the hope for the future of the Valley’s poultry industry.

“I’ve rarely seen people so driven to succeed in the face of adversity,” says Peter Thomas, business and cooperative programs administrator for USDA Rural Development. “I’m glad USDA was able to lend its support to help keep this vital industry alive in the Shenandoah Valley. This project shows how much can be achieved when you have a total commitment by producers and their communities.”

## **Plant closure stuns Valley**

This story begins when Pilgrim’s Pride — one of the nation’s major poultry companies — announced that it was exiting the Shenandoah Valley turkey industry and would be closing its processing plant near Harrisonburg by Sept. 1, 2004. That news sent a shock wave throughout the Valley and into neighboring West Virginia. The region was looking

*The Virginia Poultry Growers Co-op plant (foreground) is nestled in the rich farm country of the Shenandoah Valley. The plant was slated for closure, but a combined effort by poultry producers and supporting agencies will keep it open under farmer ownership. Photo by Nathan Holleman*



at the loss of \$200 million to the local economy, the loss of 900 plant-related jobs and more than 130 farmers would not have a contract to grow turkeys. These growers quickly came to grips with the fact that they were likely to lose their farms if they didn't act quickly.

Turkey producers (grow-out, breeders and egg producers) almost immediately hit on the idea of forming a grower co-op that could take over the processing plant operation in Hinton, Va., as occurred in recent years in Iowa and Michigan. They had an unwavering faith (personal and professional) that they could develop a successful business, even though circumstances made it impossible for them to follow the standard cooperative development format. What they didn't have was time, and they knew that a business plan rushed has been the doom of many an otherwise sound business.

But the producers believed from Day One that they could, and would, succeed in spite of the conventional wisdom that says it takes 12-18 months to plan, determine the feasibility and develop a business plan for a new value-added processing business. Due to the short window of opportunity, poultry growers had to move toward implementation *before* completing these steps.

The perennial problem of capitalization of a value-added venture was solved through a package of resources that included producer capital, commercial financing from the Farm Credit System, funding from USDA Rural Development and funding from both Virginia and West Virginia state governments.

*These individuals refused to buckle in the face of unbelievable obstacles and challenges.*

All of this happened after the April 26, 2004, announcement by Pilgrim's Pride that it was closing its turkey-processing plant at Hinton, Va., and canceling grower contracts. Pilgrim's Pride said the closure was brought on by major changes in the turkey industry and by its desire to focus operations on other plants that produced value-added turkey products (such as

sliced deli meats), as opposed to the bird parts produced in the Hinton plant.

Not just Pilgrim's Pride, but the entire turkey industry is undergoing major changes. Many major players are changing their marketing strategies and focus. While on-farm and wholesale turkey prices have been above average in the past six months, the five-year average is far lower. Outbreaks of avian influenza in early 2004 in the Valley and in the adjacent states of Delaware, Maryland, New Jersey and Pennsylvania, as well as in Texas, hit the industry hard. But these facts did not deter the producers.

The likely impact of all those lost jobs, farms and related revenue soon attracted the attention of local, state, and federal government officials, who began offering technical and financial help.

#### How they did it

So how did the turkey producers manage to make the transition from contract growers to owners and operators of a major turkey processing business and feed mill in just 181 days? Here are the major steps:

#### *(All dates in 2004)*

- May 21 — growers met and voiced support to determine whether they could buy the Pilgrim's Pride plant in Hinton.
- May 26 — growers file articles of incorporation for the Virginia Poultry Growers Cooperative; charter issued.
- May 31 — co-op steering committee/board sends letter to turkey growers requesting growers contribute 15 cents per-square-foot of housing. Within two weeks, more than 90 growers had contributed \$994,000 for the feasibility effort.
- June — Pilgrim's Pride stops placing poults (young turkeys) with members.
- June — Southern States Cooperative Foundation becomes involved in helping the new cooperative on legal and feasibility issues, agreeing to



*Co-op President Sonny Meyerhoffer addresses growers during the membership drive for the new co-op. The plant, operating under the co-op since November, is exceeding projected operating goals. Photo by Michael Reilly, Courtesy Harrisonburg, Va., Daily News-Record*



develop an integrated financial model to capture and test assumptions.

- June — board begins purchasing eggs to place poult in growers' poultry houses.
- June - Pilgrim's Pride announces plans to sell its hatchery, but not to the co-op. This creates additional issues, because 20 percent of the growers are breeder-producers, who would have to switch to grow-out operations.
- June 26 — co-op holds second grower meeting.
- July 12 — co-op converts to a stock corporation, enabling it to raise capital through the issuance of preferred and common stock.
- July 14 — co-op holds third grower meeting and announces that it has signed a non-binding letter of intent with Pilgrim's to purchase the Hinton plant, the Broadway, Va., feed mill and inventory of supplies and birds on or before Aug. 31, 2004.
- July 16 — co-op files an application with the Internal Revenue Service (IRS) for recognition as a tax-exempt cooperative under Section 521 of the Internal Revenue Code.
- July 22 — IRS approves the 521 application, meaning that the co-op

can have members in both Virginia and West Virginia, without the expensive and time-consuming process of SEC registration.

- July — co-op finalizes agreement with a national premium deli meat processing company on products to be produced; the company also agrees to invest in the plant.
- July — co-op meets with CoBank and other Farm Credit System lenders to secure financing.
- August — negotiations with Pilgrim's Pride continue.
- September 15 — co-op signs purchase agreement with Pilgrim's Pride.
- September-October — co-op begins to hire management staff and announces plans to begin processing of turkeys after Thanksgiving.
- October — co-op begins interviewing and taking applications for processing staff.
- October 13 — co-op receives \$8 million loan under USDA Rural Development's Rural Economic Development Grant (REDLG) program (through Shenandoah Valley Electric Co-op).
- November 28 — co-op begins processing members' turkeys.

Thus, in just six months, did VPGC go from having an idea to implementing that idea.

Today, the co-op has 136 members in a 10-county area of Virginia and West Virginia. It owns a multi-million-dollar turkey processing plant, a feed mill and associated equipment to pick up turkeys from members' farms. Its members currently have plans to grow more than 6 million turkeys annually. It has significant, sustainable contracts with customers throughout the eastern United States.

### **Factors for successful co-op development**

But the question remains, why has this group of producers been able to advance its co-op far more rapidly than so many others?

When the Southern States Cooperative Foundation conducts an initial evaluation with a new group of producers — as it did with these poultry growers — it shares with them the keys to success that any business project must have. These include:

- 1) a good idea;
- 2) a clear vision;
- 3) committed leadership;
- 4) producer support (putting their dollars at risk);
- 5) government support (local, state, federal);
- 6) access to commercial credit;
- 7) focused planning and analysis;
- 8) good communication with members;
- 9) perseverance.



Here's the Foundation's perspective on how well Virginia Poultry Growers Cooperative met these criteria:

- VPGC had a good idea — though execution was a challenge, especially due to the time constraints;
- Members absolutely had a clear vision and could articulate it with passion;
- Leadership was absolutely committed to the co-op, even to the extent that their farms and families took a back seat for at least six days a week for virtually the entire six months.

\$250,000 to growers on its side of the state border to invest in the cooperative. Support from the USDA Rural Development was critical to the project's success. It provided assistance on two levels. First, it provided significant financial assistance in the form of the \$8 million REDLG and a still-pending \$5 million Business & Industry loan guarantee. The other level of help was in technical assistance from Rural Development's Cooperative Services office, which helped with organiza-

standing cooperation in the development of the financial feasibility analysis and modeling. SSCF's legal counsel worked closely with the co-op's local counsel.

- At every step of the process, good communication with growers and perseverance of the steering committee and the board kept this cooperative focused and on-plan.

### Grower contracts reflect member input

Another element leading to the cooperative's success was the foresight of the steering committee to involve growers in the design of grower contracts. This created trust and cooperation, and removed any hint of "us vs. them," which so often occurs in the poultry industry between integrators and contract growers.

The board also made a commitment to hire quality, professional management to oversee operations. Early on, the board identified a well-qualified manager for the cooperative, a seasoned veteran in the processing industry, skilled marketers, and food safety staff to train processing staff and monitor and test product quality.

Is the future success of the cooperative assured? Of course not, but it has a strong game plan for success. Are there bumps in the road ahead? Absolutely. No business has ever gone through start-up without encountering the "hidden bummer factor."

That this development project succeeded in a co-op launch can clearly be attributed to a number of important factors, mainly: unwavering dedication and the hard work of the co-op leaders and members; the cooperation and coordination of many producers and professionals and a dose of luck.

VPGC can stand as a model for producers on how to create "co-op development fever," and for professional development practitioners, private businesses and government economic-development staff on how to coordinate and work together to make a cooperative vision a reality. ■



Sonny Meyerhoffer, third from left, and other co-op officers receive a ceremonial check for \$8 million from USDA Rural Development outside the plant's headquarters at Hinton, Va.

- Producers stepped up with dollars — almost \$1 million in the first 30 days and a significant amount thereafter as the purchase neared. However, they fell short of what was needed to secure sufficient commercial financing to fully capitalize the cooperative.
- Poultry growers had vitally important government support at all levels. Locally, the county is providing incentives to the cooperative. At the state level, the Virginia Dept. of Commerce made a \$500,000 grant to the cooperative; the West Virginia Department of Agriculture provided

tional guidance and support. Rep. Robert Goodlatte of Virginia, chairman of the House Agriculture Committee, and his staff also provided critical support.

- The co-op has had access to commercial credit, which was essential to the cooperative's purchase of the processing plant and feed mill. That credit came through Farm Credit System's institutions: Farm Credit of the Virginias and CoBank.
- The cooperative made a clear, unequivocal commitment to planning and analysis. The Southern States Foundation was given out-



# A Perfect Storm

*Farmland trustee sues ex-officers, directors for 'gross negligence' in co-op's collapse*

By Dan Campbell, Editor

**I**n its final years, Farmland Industries was trapped in a “death spiral of debt,” made worse by a series of business blunders that evidence reckless and negligent behavior by the co-op’s managers and board, according to a lawsuit filed in February by the estate trustee for Farmland.

The lawsuit accuses the co-op’s former managers and directors of “gross negligence and acts of corporate waste” in carrying out their duties, resulting in the largest co-op bankruptcy in the nation’s history. The board was little more than “a rubber stamp” for management’s high-risk ventures, the lawsuit says, and directors repeatedly failed to demand that other obvious alternatives be explored.

The 34-page lawsuit reads a bit like a “how-not-to-run-a-cooperative” primer, complete with lessons in “throwing good money after bad.” That impression could, of course, change markedly when the defendants file their response (which was due in March, after the copy deadline for this magazine). The pre-trial hearing has been slated for May 10.

The lawsuit, filed in U.S. Bankruptcy Court in Kansas City by J.P. Morgan Trust Co., does not paint a pretty picture of how the ship of state was being guided in the final years of Farmland. It provides a detailed look into how Farmland tried to grow its way out of debt by taking on even more debt as it constructed major new facilities and acquired

another failing farm supply business. In the end, Farmland succeeded only in swamping itself in an ever-deepening sea of red ink, which led to its bonds being downgraded to “junk” status.

That resulted in the co-op having to pay higher interest rates. A “run on the bank” by panicked bondholders ensued when press reports picked up on the co-op’s intensifying financial troubles. Farmland filed for Chapter 11 (reorganization) bankruptcy in 2002. Since then, the assets of the one-time Fortune 500 company — with \$11.8 billion in annual sales and 600,000 members — have been sold off.

The suit builds its case on a series of seemingly self-destructive actions the co-op took, or didn’t take, primarily during the tenure of CEO Harry Cleberg from 1992 until 2000. The suit also names his successor, Robert Honse, along with 27 former board members.

Ben Mann, a Kansas City attorney representing Cleberg and former Chairman Al Shively, says the lawsuit “is nothing but second guessing” by the trustee, and that none of the claims have merit. He declined further comment pending his clients’ formal response to the lawsuit.

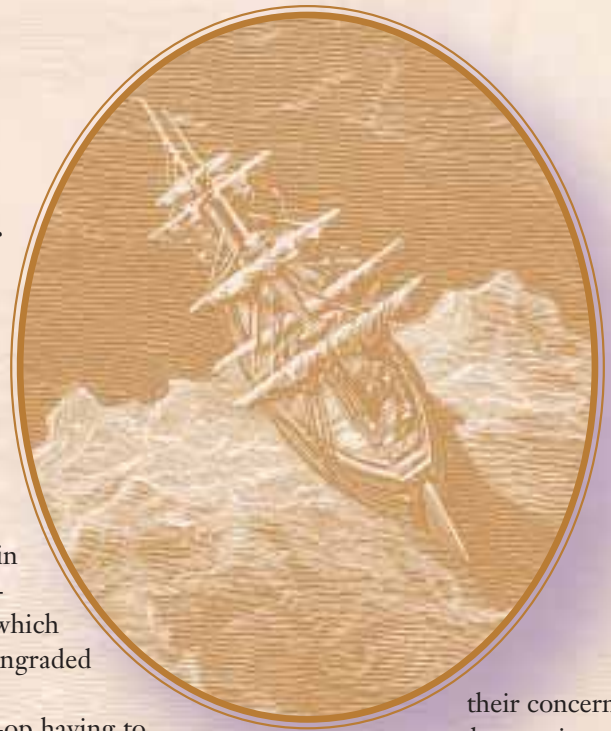
## **Fertilizer plant: a co-op killer?**

Perhaps the handwriting on the wall for Farmland Industries appeared in 1999, when CHS members voted down a proposed merger with Farmland. In turning it down, CHS members cited

their concern over the massive debt levels Farmland had assumed and displeasure with the big pay checks management of the two co-ops would have collected as part of the deal.

The biggest nail in Farmland’s coffin, according to the lawsuit, was the decision to build a \$300-million nitrogen fertilizer plant close by its petroleum refinery in Coffeyville, Kan. The new fertilizer plant was to use a commercially unproven technology from Texaco that used petroleum coke (produced as a byproduct of refining petroleum) instead of natural gas as a fuel source for anhydrous ammonia-based fertilizer. This technology was not being used commercially anywhere in the United States at the time and in very few places globally.

Farmland relied on fertilizer sales for up to 70 percent of its income in the 1990s, the lawsuit says. However, in the early ‘90s, management had recommended that Farmland exit the highly volatile fertilizer business. Fluctuating demand caused by changes in cropping patterns and government farm programs, weather conditions and competition from imports were making the fertilizer trade seem like an endless rollercoaster ride. Natural gas prices also fluctuate widely, but Farmland believed the long-term out-



look was for steadily rising gas prices, hence its decision to seek an alternative energy source for the manufacture of anhydrous ammonia.

The lawsuit says the board approved the fertilizer plant “after woefully inadequate due diligence,” relying primarily on “self-serving data provided by Texaco.” Further, this investment was made at a time when the co-op was already carrying close to \$1 billion in debt, when demand for fertilizer was dropping and imported fertilizer was grabbing more of the domestic market.

Farmland calculated the payback on the new plant would have been \$28 million per year, or nine years to recoup the construction expenses.

### **Inadequate research alleged**

“Farmland never hired any third party or outside consultant to advise [it] on the completeness and accuracy of Texaco’s representation,” the suit says. The co-op’s main research consisted of a single trip by Honse and one other co-op employee (a former Texaco employee) to a small plant in Japan that was using the technology. No board members made the trip, and no contacts were made with customers of the plant, which had experienced start-up problems.

Gasification technologies other than Texaco’s were available in the United States at that time, and the Tennessee Valley Authority had built a gasifier that used petroleum coke to produce ammonia. None of these options were investigated by Farmland, the suit says.

Another promising alternative would have been to expand the co-op’s joint venture with Mississippi Chemical on the Caribbean island of Trinidad, where Farmland was then securing natural gas for only 40 percent of the cost of domestic natural gas. But that option was given “only a cursory consideration,” the lawsuit says. Other off-shore suppliers also could have been tapped as low-cost gas suppliers, but again, such options were not explored.

Ultimately, the co-op spent less than \$2 million investigating the mer-



its of the Coffeyville fertilizer plant, and allotted only 25 minutes of its agenda to the topic before approving it in April of 1997, the suit says. The entire Coffeyville complex — fertilizer plant and refinery — were eventually sold for just \$11 million, leaving it with a \$300 million loss on the fertilizer plant alone.

Farmland’s decision to enter some major joint ventures — with ADM for grain marketing and with other co-ops in Agriliance for fertilizer — caused it to lose control over the ability to set prices for those commodities, the lawsuit says.

### **SF Services acquisition**

J.P. Morgan Trust contends that Farmland’s leaders failed to perform due diligence when it decided in April

1998 to acquire SF Services, a faltering, federated farm-supply co-op with \$100 million in debt. SF Services was not only losing money and burdened with debt, it had “a significant problem with its pension plan” and was locked in a dispute with the IRS. Farmland “hired no outside consultant to advise it regarding the merger,” the lawsuit says.

SF Services — which did business in Arkansas, Louisiana and Mississippi — never made money for Farmland. “All the money was lost. These losses were foreseeable and completely avoidable,” the lawsuit alleges.

These types of actions, it continues, reflected Cleberg’s philosophy that “Farmland needed to grow ever bigger. During his tenure as CEO, the focus was on growing sales volume and diversifying operations, not on the bottom line — profitability. From 1996 to 2000, the co-op took on an additional \$400 million in debt, boosting total indebtedness to \$1.3 billion.”

The lawsuit alleges that accounting tricks were used to mask its true financial condition. “Gross revenues increased significantly until 2002, giving the appearance that Farmland was a growing company, when its profitability was in truth steadily declining.” Expansion, including the Coffeyville fertilizer plant, “was funded through the use of off-balance sheet financing.” Furthermore, Farmland “changed certain accounting practices that added billions of dollars in revenue to the company,” masking how leveraged it was, the suit alleges.

Rubbing salt in the wound was a \$700,000 “sweetheart bonus” Cleberg received in 1999, during a year in which his primary focus was on securing approval for the merger with CHS. Having failed to accomplish this goal, the suit questions why he was given a bonus equal to more than his annual base salary. Cleberg and Honse reached a settlement with the creditors last September which allowed them to collect \$7.4 million and \$3.6 million (respectively) in deferred compensation and retirement benefits.



## A perfect storm

While the defense attorneys aren't saying much at this point, some others who have followed the case say a number of negative factors converged to bring down Farmland. The Coffeyville plant was "located in just about the worst place it could be," says David Barton, director of the Arthur Capper Cooperative Center at Kansas State University. "It was located in an 'over-supplied' market with limited marketing flexibility resulting in relatively low prices and needed major environmental updating."

And while he agrees that it was a major negative for the co-op, Barton cites three primary reasons for Farmland's failure:

- it pursued a high-risk business strategy based on highly leveraged growth;
- it failed to execute properly when confronted with major problems;
- it was hit by a "perfect storm" of negative conditions that converged on it in the final years of its operation, the biggest of which was probably high natural gas prices that "totally changed the economics of manufacturing fertilizer. Farmland just couldn't reposition itself fast enough to switch over to off-shore supplies," Barton says.

There was also "a sea change" occurring in the grain business which worked against Farmland. Less grain volume was being shipped to its traditional inland grain terminals and instead was moving to smaller, high-speed train load-out facilities dispersed throughout the grain belt.

### "Recklessness" hard to prove

Farmland had shown strong intentions of wanting to transition from being a farm supply and grain business to being a producer of processed meats. It had been moving in that direction and was operating successful pork and beef operations when the roof began to fall in.

Had Farmland started sooner in making the transition to a food co-

op, perhaps today we would be hailing it as a model of a co-op that successfully reinvented itself for the 21st century, rather than as the biggest co-op failure in history.

But the good performance of the meat processing businesses was not directly serving the needs of its primary owners and patrons, the Farmland local co-op members, who wanted the co-op to perform better as a source of farm supplies and as a grain marketer, says Barton.

There also may have been a method to what the lawsuit paints as madness regarding the money spent on the Coffeyville fertilizer plant. Farmland had been trying for years to sell the Coffeyville petroleum refinery, but without success. Had the fertilizer plant been successful in using byproducts from the refinery to produce fertilizer, it might have made that entire operation marketable.



According to a March 11 report in *Kansas City Star*, the Coffeyville complex, which some called an albatross, is now paying off for Pegasus Capital, which paid only \$22 million in cash (plus some other considerations) for the refinery and fertilizer facilities. In its first year running the plant, Pegasus says it will earn \$100 million in operating income, making it what the owners call "the lowest-price producer of fertilizer in the world." So perhaps the technology was not flawed, but only in need of fine-tuning.

The business, now operating under the name Coffeyville Resources, has announced that it is going public and hopes to raise \$300 million.

It is the job of the trustee to get as much as he can for the debtors in a bankruptcy, but proving recklessness may be an uphill battle in this case, according to some legal experts. It is important to note that this lawsuit does not allege fraud, nor that actions were taken for the personal enrichment of the defendants. And while the suit certainly alleges that some very poor business decisions were made by management and the board, the court may not agree that this constitutes negligence or failure to perform due diligence. That is a heavy burden to prove. If it does, most companies and co-ops carry liability insurance to protect the directors from any personal liability.

In essence, the lawsuit poses the question: at what point do (alleged) bad business decisions cross the border into the realm of failure to perform due diligence?

The closest the lawsuit comes to alleging fraud is when it makes allegations of "off-balance-sheet financing" and "changing accounting practices" to mask indebtedness.

In this environment, management and directors more than ever need to do their homework, properly research major business moves and make sure all accounting and financial statements are above board and accurate. ■

## Why wasn't Farmland reorganized?

Heads have been turned and eyebrows raised in co-op circles by reports of the unusually high payouts creditors are receiving from the estate of bankrupt Farmland Industries. Secured creditors (essentially the co-op's lenders) have been paid in full, about \$500 million. The 60,000 unsecured creditors (including about 20,000 bondholders) have been paid 95 cents on the dollar, or more than \$800 million, with prospects for getting even more.

Those are remarkable payback figures, considering that the average in bankruptcy cases is closer to 10 cents on the dollar for unsecured creditors and 80 cents on the dollar for secured creditors.

Holders of \$100 million in Farmland preferred stock have not fared as well, with an estimated payback of only about \$4 million at this time. Local co-ops lost all of their equity investment (or common stock) in Farmland.

So why wasn't Farmland reorganized, as are so many other companies that file for Chapter 11 Bankruptcy? The case seems to have been handled as a Chapter 7 liquidation almost from the start — and it seems there was never any real intent to save the business, some former co-op members have complained. Some have also questioned whether Smithfield Foods was able to exert pressure to steer the case toward liquidation because it wanted to gain control of Farmland's highly coveted pork operations.

Larry Frazen of the Kansas City law firm of Bryan Cave, Farmland's attorney, says he understands why former members and others are doing a double take when they read reports of how well creditors have fared, but he does not share the belief that this is an indication that Farmland should have, or could have, been successfully reorganized.

"Sometimes the assets of a co-op may be worth far more when it is broken up than when whole, as in this case," Frazen says. In the case of Farmland, it operated numerous divisions and joint ventures — fertilizer, petroleum, grain, pork, beef, feed, transportation — which did not necessarily complement each other well, he notes. Furthermore, no one anticipated the very big sale prices many of the co-op's best assets fetched.

The management team did make an offer to reorganize the co-op, Frazen says, but the two unsecured creditors' committees (one for bondholders and one for trade creditors) wanted to liquidate. "They wanted cash."

While Smithfield did indeed buy up some creditors' claims against Farmland, Frazen said it was never to the extent that the Virginia-based pork company could have

blocked a reorganization had the creditors' committees decided to go that route. But Smithfield did gain standing on the creditors' committees, he noted.

The creditors included banks that were adamant about being repaid, and many bondholders who were equally eager to get their cash out. It was many of these same small bondholders who were spooked by press reports of Farmland's growing debts that sparked a "run on the bank" in 2002.

The resulting "cash crunch" was the culmination of what Frazen also calls "a perfect storm" of events that doomed the co-op. Farmland had been greatly weakened by three successive years of poor planting conditions, causing fertilizer sales to plunge just when the co-op could least afford it.

David Barton, director of the Arthur Capper Cooperative Center at Kansas State University (KSU), cites two main reasons for Farmland's inability to reorganize under bankruptcy: 1) bondholders would have had to agree to convert their bonds into preferred stock in the co-op, and few had any interest in doing so; and 2) members would have had to invest more money in the co-op, and few showed a willingness and interest to do so.

"Local co-op members had other options where they could take their business, rather than investing more in Farmland," says Barton, who has been tracking Farmland's fate both as an academic whose work focuses on co-ops, and as an unsecured creditor himself (he was owed for some consulting he did for the co-op). The KSU Co-op Center was also an unsecured creditor.

Because so many of the co-op's bondholders were relatively small investors living in rural areas and associated with local co-ops, some of whom had invested the majority of their retirement funds in the bonds, there was a strong sentiment at Farmland to strive to repay as much of the bond debt as possible, Barton says.

Once the co-op's assets went on the block, some spirited bidding wars broke out, none keener than for Farmland's pork operations, where Smithfield vs. Cargill bidding ran up the price to \$481 million. Smithfield even picked up the obligation for Farmland employee pensions, a real stroke of good fortune for workers caught up in a bankruptcy, Frazen says.

"It is kind of funny that you can get criticized for doing your job almost too well — for getting as much as you can for the creditors — in a case like this," Frazen says. "Farmland's management worked very hard to make sure as few as possible were hurt by the co-op's bankruptcy." ■ — Dan Campbell, editor



# Farmland faced classic co-op dilemma

**Thomas W. Gray, Ph.D**

Rural Sociologist

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Agricultural cooperatives are at once democratic associations of member-producers as well as businesses. This dual function of democracy and business results in various trade-offs and tensions that become a basic part of cooperative structure. Embedded are values of equality, equity, participation and self-governance (the democracy function,) but also values of efficiency, performance and economic return (the business function.) In their operations, cooperatives struggle to meet both sets of needs, sometimes successfully dancing between them, sometimes falling to one side or the other.

Many cooperatives were formed to help empower farmers to compete with much larger business organizations.

Farmland Industries, from its inception as Union Oil in 1929, was formed to oppose the market power of such giants as Standard Oil and Sunoco. Farmland sought to empower farmers by competing with Big Oil. This led the cooperative down a path (with

much of the rest of U.S. agriculture) of energy-intensive, agricultural industrialization, and into big business operations.

Conglomeration has been the predominant organizational strategy of big business, commencing with the Depression and World War II. Spreading investments across several different activities, subsidiary firms and locations (conglomeration) can diversify organizational vulnerability and risk. In an era that has come to be dominated with multi-nationalized firms, Farmland Industries grew to operate in all 50 states and 60 counties, with 600,000 members and 1,700 local cooperative owners.

Cooperatives are organized with the member in mind. Members are to be the prime beneficiaries. However, in a multi-national cooperative such as Farmland, complexity rules. It can become unclear who the prime beneficiaries and critical decision makers are.

Do the primary benefits of cooperatives get lost in shifts between business management prerogatives vs. the democratic rights of the members? Do membership interests get lost to the investment interests of "outsiders" in joint ventures? What group of interests is making crucial decisions of the organization that shape future directions? Complexity "confuses" any easy answer to these questions.

Had Farmland taken a different, less extensive path of development, member participation in the organization may have been higher. Complexity always leads to losses of member involvement and, generally, to increases in centralized decision making. To the extent that centralization occurs, the cooperative is less member-oriented because members are less involved.

More member involvement allows for more input and can produce greater flexibility and creativity. We might wonder if a more active democracy (one closer to the mem-

bers) could have led to different structures and operations (if more modest) and to better survival rates of farmers and, ultimately, of the organization.

However, the tension from the business side of the organization may claim that while democracy

is central to cooperative organization, to act without recognition of market imperatives (e.g., the need for earnings, market innovation, and countervailing power in the market place) can very easily eliminate the cooperative all together.

Ultimately, the members of a cooperative can demand that: 1) those who own and finance the cooperative are those who use the cooperative; 2) those who control the cooperative are those who use the cooperative; and that 3) the cooperative's sole purpose ultimately is to provide and distribute benefits to its users on the basis of their use of the organization (Dunn).

However, the ease with which these principles can be stated belies the complexity of responding to member needs and rights of use, in an environment of globalization, industrialization, multi-national competitors, and such ever-present needs as capitalization. ■



# Court of Preference

*Minnesota co-op helps manufactured home residents avoid closures, evictions that plague other courts*

**By Angela Dawson,**  
**Communications Director**  
Northcountry Cooperative  
Development Fund  
Center for Cooperative  
Enterprise and Innovation

In manufactured home park communities in rural Minnesota, it's common for residents to own their homes but to rent the lot on which their home is located. The park owners usually don't live in the park, but still make the rules for people who live there.

Eventually, an eager commercial real estate developer approaches the land owner with an attractive bid to buy the park. Too often, the

story plays out with the eviction of families from the homes they've lived in for years, and a permanent loss of affordable rural housing.



*Resident-members of Sunrise Villa have formed Minnesota's first manufactured housing cooperative. Photo courtesy Northcountry Cooperative Development Fund*

In the case of Sunrise Villa Manufactured Home Park in Cannon Falls, Minn., Rick and Becky Ruddy had come to know Sunrise Villa as home for 15 years. Then the owner decided to sell the park. Instead of packing up and looking for another home, the residents of Sunrise Villa — with the help of Northcountry Cooperative Development Fund (NCDF) — got organized and became Minnesota's first manufactured home park cooperative.

The creation of Sunrise Villa Cooperative goes against an unfortunate trend of mobile home park closings across the state, a trend that NCDF

*continued on page 39*

## Co-op Living Web site brings value to co-op housing market

NCDF recently launched [www.coopliving.coop](http://www.coopliving.coop), an online housing co-op listing service that adds value to the co-op housing market. Until now, co-op housing residents were forced to use conventional methods to list and sell shares in their units, including listings in local papers or multiple listing services.

Unfortunately, the listings compete with thousands of conventional real estate listings, and sellers couldn't target the market of interested cooperative buyers. Not any more! In an effort to make it easier to buy and sell a co-op housing share, the co-op listing service provides a centralized location in which buyers and sellers of co-op housing can connect.

NCDF has also published the *Cooperative Housing Toolbox: A Practical Guide for Cooperative Success*.

This toolbox is a "best practices" guide for housing cooperative boards of directors, committees and members. For information on ordering, contact: (612) 331-9103, or [info@ncdf.coop](mailto:info@ncdf.coop).

NCDF is a cooperatively owned and operated financial intermediary which acts as a catalyst for the development and growth of cooperatives. NCDF embodies the sixth Rochdale principle of "cooperation among cooperatives," offering co-ops and socially motivated institutions and individuals a means to pool surplus funds and then reinvest those funds in the community. ■







# Antitrust developments; case against mushroom growers' co-op settled

**By Marlis Carson**

Vice President, Legal,  
Tax and Accounting  
National Council of Farmer  
Cooperatives

**Donald Frederick**

Program Leader for Law,  
Policy & Governance  
USDA Rural Development

**T**wo recent developments should remind agricultural cooperative leaders that they can not take for granted the limited antitrust protections accorded associations of producers.

The first is the decision by the new Antitrust Modernization Commission to study all antitrust exemptions, including those enacted to promote cooperative marketing of agricultural and aquacultural products. The second is the settlement of an antitrust suit against a mushroom marketing cooperative that resulted in the association agreeing to cease activities the Department of Justice felt were outside the scope of applicable antitrust shields.

## **Antitrust Modernization Commission**

In 2002, Congress created the Antitrust Modernization Commission (AMC) to examine whether the antitrust laws should be “modernized” and to submit its findings to Congress and the President. The AMC is a 12-

member, bipartisan commission consisting primarily of antitrust lawyers with large law firms and major corporations. The commissioners plan to complete a draft report by the summer of 2006 and to submit a final report in the spring of 2007.

Once appointed, the AMC established eight working groups to develop recommendations for issues the commissioners should study. The AMC met on Jan. 13 in Washington, D.C., to discuss those recommendations.

At their January 2005 meeting, the commissioners unanimously agreed to accept the Immunities and Exemptions Working Group’s recommendation that the AMC study all antitrust immunities and exemptions (both statutory and those based on case law) to determine whether they should be eliminated if not justified by the benefits they provide, or if they should otherwise be time-limited. The list of exemptions to be considered includes:

- Section 6 of the Clayton Act (authorizes the formation of non-stock agricultural co-ops);
- The Capper-Volstead Act (permits cooperative marketing by associations of agricultural producers), and
- Fishermen’s Collective Marketing Act (similar to Capper-Volstead, but protects associations of aquacultural producers).

In a letter to the AMC, the Department of Justice did not mention any of the producer-oriented exemptions but

did call attention to exemptions that can “...undermine our global leadership in advocating market-based approaches in other jurisdictions. Among the immunities and exemptions that deserve to be studied are the Shipping Act, 46 U.S.C. § 813, the Export Trading Company Act, 15 U.S.C. §§ 4011-21, and the Webb-Pomerene Act, 15 U.S.C. §§ 61-66.”

At the conclusion of the January meeting, the working groups were instructed to prepare written proposals detailing how their recommendations should be carried out. The commissioners anticipate they will eventually hold hearings and receive testimony from industry representatives.

Information about the AMC, its commissioners and the initial reports of all Working Groups are available at: <http://www.amc.gov>. Producer-owned marketing cooperatives will want to keep abreast of commission actions and be ready to defend their antitrust protections if necessary.

## **Mushroom growers case settled**

In December 2004, the Department of Justice simultaneously filed an antitrust lawsuit against the Eastern Mushroom Marketing Cooperative (EMMC) of Kennett Square, Pa., while also entering into a consent decree settling the case. EMMC, in an attempt to limit mushroom production by non-members of the cooperative,

*continued on page 41*

# Upswing Continues

*Despite loss of Farmland & Agway, revenue, income climb for top 100*

**By David Chesnick, Ag Economist**  
USDA Rural Development

**T**here was a dramatic change in the landscape of the nation's 100 largest agriculture cooperatives in 2003. No longer were Farmland and Agway included in the top 100 co-op list, as both closed their doors. However, this does not mean the agriculture cooperative sector, as a whole, is on a downswing. Indeed, quite the contrary is true. In preliminary findings, the largest agriculture cooperatives had a jump of 7.8 percent in total operating revenue while net margins and patronage to members each soared 39 percent in 2003 (table 1).

Based on USDA's annual survey of cooperatives, the top 100 co-ops had operating revenue of \$58.3 billion, up from \$54.1 billion in 2002. That's about half of total revenue for the nation's 3,000 farmer-owned co-ops. Marketing activity contributed 72 percent, farm supply sales 26 percent and "other revenues" 2 percent of total revenue for the top 100 co-ops.

Leading the increase were the "diversified" category of cooperatives, with a jump of \$2.1 billion in total revenue. Farm supply sales for diversified cooperatives — those that primarily market members' grain and sell them farm supplies — were up 38 percent, to \$8.1 billion. This marks the first time farm supply sales were greater than marketing revenue for diversified cooperatives.

Grain and farm supply cooperatives also showed substantial gains in revenue, with each group adding more

than \$1 billion to total revenue. Fruit and vegetable cooperatives had a \$1 billion decline in total revenue. However, most of the decline was due to a restructuring activity that will help a co-op improve its bottom line.

## Margins soar

Net operating margins (gross margins less operating expenses) were up 10.4 percent, to \$980 million. Most of the increase came from diversified cooperatives, where net operating margins jumped \$125 million, to \$268 mil-

**Table 1—Combined Operating Statement—Top 100, 2002-03**

|                                    | 2003        | 2002       | Difference | Percent Change |
|------------------------------------|-------------|------------|------------|----------------|
|                                    | \$ thousand |            |            |                |
| <b>Revenues</b>                    |             |            |            |                |
| Marketing                          | 42,224,706  | 41,473,012 | 751,694    | 1.81%          |
| Farm Supply                        | 15,088,921  | 11,700,590 | 3,388,331  | 28.96%         |
| Total Sales                        | 57,313,627  | 53,173,602 | 4,140,025  | 7.79%          |
| Other Operating Revenues           | 1,025,113   | 931,834    | 93,279     | 10.01%         |
| Total Operating Revenues           | 58,338,740  | 54,105,436 | 4,233,304  | 7.82%          |
| Cost of Goods Sold                 | 53,169,267  | 49,038,973 | 4,130,294  | 8.42%          |
| Gross Margin                       | 5,169,473   | 5,066,463  | 103,010    | 2.03%          |
| <b>Expenses</b>                    |             |            |            |                |
| Operating Expenses                 | 4,189,713   | 4,178,604  | 11,109     | 0.27%          |
| Net Operating Margins              | 979,760     | 887,859    | 91,901     | 10.35%         |
| <b>Other Revenues (Expenses)</b>   |             |            |            |                |
| Interest Expense                   | (422,183)   | (479,844)  | 57,661     | -12.02%        |
| Interest Revenue                   | 27,291      | 36,331     | (9,040)    | -24.88%        |
| Other Income                       | 334,954     | 358,402    | (23,448)   | -6.54%         |
| Other Expenses                     | (113,360)   | (73,455)   | (39,905)   | 54.33%         |
| Patronage Revenue                  | 99,167      | 64,201     | 34,966     | 54.46%         |
| Net Margins from Operations        | 905,629     | 793,494    | 112,135    | 14.13%         |
| Non-Operating Rev. (Exp.)          | (34,993)    | (170,694)  | 135,701    | -79.50%        |
| Net Margins                        | 870,636     | 622,800    | 247,836    | 39.79%         |
| <b>Distribution of Net Margins</b> |             |            |            |                |
| Cash Patronage Dividends           | 264,589     | 191,048    | 73,541     | 38.49%         |
| Retain Patronage Dividends         | 453,028     | 397,276    | 55,752     | 14.03%         |
| Nonqualified Noncash Patronage     | 7,097       | 4,249      | 2,848      | 67.03%         |
| Dividends                          | 9,728       | 9,858      | (130)      | -1.32%         |
| Unallocated Equity                 | 87,343      | 3,879      | 83,464     | 2151.70%       |
| Income Tax                         | 48,851      | 16,490     | 32,361     | 196.24%        |
| Total Distribution                 | 870,636     | 622,800    | 247,836    | 39.79%         |



lion. Poultry/livestock cooperatives showed the largest decline in operating margins, which fell \$106 million, leaving them with a net operating loss of \$41 million.

Overall net margins from operations (which exclude all non-operating revenues and expenses) hit \$906 million in 2003, an increase of 14.1 percent for the top 100. Much of the gain was due to fruit/vegetable cooperatives, which saw net margins from operations climb by \$105 million, to \$261 million. Non-operating revenues and expenses gener-

ally include gains or losses from disposing capital assets, accounting changes or other one-time revenue or expenses not related directly to operations.

Net margins — the bottom line for cooperatives — increased 39.8 percent, to \$870 million for the top 100 co-ops in 2003. With the exception of diversified, grain and poultry/livestock cooperatives, all commodity groups showed substantial gains in net margins. Poultry/livestock cooperatives were the only commodity group to have a net loss (\$64 million).

### More patronage goes to members

The top 100 cooperatives allocated 82 percent, or \$718 million, of net margins back to their members as patronage in 2003. Of that amount, \$265 million was in cash payments to members while the remaining \$453 million was retained by the co-ops. Dairy cooperatives led the way, allocating 94 percent of net margins back to members.

Non-qualified, non-cash patronage refunds were up 67 percent, to \$7 million. Dividends remained fairly constant, at \$10 million. Unallocated equity, which was used to absorb net losses in prior years, absorbed \$87 million of the net margins, up \$83 million from 2002. Fruit/vegetable cooperatives was the primary co-op group still using unallocated equity and tax benefits to absorb net losses.

Patronage refunds received by the top 100 co-ops reached \$99 million in 2003, up 54.5 percent. Much of this increase was reaped by diversified cooperatives, which saw patronage increase 125.2 percent, to \$61 million.

### Goods, labor costs rise

Cost of goods sold by the top 100 co-ops was up 8.4 percent, with most of the increase occurring among diversified, grain and farm supply cooperatives. These three commodity groups also accounted for the largest increase in total operating revenue.

Operating expenses were up a slight .3 percent, to \$4.2 billion, due in part to higher labor costs. Cooperatives that reported labor expenses indicated costs were up 5 percent from 2002. Labor as a percent of total expenses rose from an average of 65 percent of total expenses to 68 percent in 2003.

The largest increase in operating expenses occurred in the grain sector, up 12.2 percent, to \$541 million. Dairy cooperatives' operating expenses jumped up \$42 million, to \$807 million. Fruit/vegetable cooperatives saw the biggest decline in operating expense, dropping 12.7 percent, to \$855 million, despite a 5-percent increase in reported labor costs.

Table 2—Combined Balance Sheet-Top 100, 2002-03

|  | 2003               | 2002       | Difference | Percent Change |
|--|--------------------|------------|------------|----------------|
|  | <i>\$ thousand</i> |            |            |                |
| <b>Assets</b>                          |                    |            |            |                |
| <b>Current Assets</b>                  |                    |            |            |                |
| Cash                                   | 980,404            | 666,959    | 313,445    | 47.0%          |
| Accounts Receivable                    | 4,644,641          | 4,547,146  | 97,494     | 2.1%           |
| Inventory                              | 5,127,491          | 4,957,569  | 169,922    | 3.4%           |
| Other Current Assets                   | 1,195,117          | 965,117    | 230,000    | 23.8%          |
| Total Current Assets                   | 11,947,652         | 11,136,791 | 810,862    | 7.3%           |
| <b>Investments</b>                     |                    |            |            |                |
| Cooperative Banks                      | 256,593            | 269,062    | (12,469)   | -4.6%          |
| Other Cooperatives                     | 1,497,540          | 1,469,814  | 27,726     | 1.9%           |
| Other Investments                      | 1,799,779          | 1,821,580  | (21,801)   | -1.2%          |
| Total Investments                      | 3,553,912          | 3,560,456  | (6,544)    | -0.2%          |
| Net PP&E                               | 6,987,926          | 7,123,988  | (136,062)  | -1.9%          |
| Other Assets                           | 2,271,118          | 2,195,705  | 75,413     | 3.4%           |
| Total Assets                           | 24,760,608         | 24,016,940 | 743,668    | 3.1%           |
| <b>Liabilities</b>                     |                    |            |            |                |
| <b>Current Liabilities</b>             |                    |            |            |                |
| Total Short-term Debt                  | 2,132,679          | 2,380,554  | (247,875)  | -10.4%         |
| Accounts Payable                       | 3,133,000          | 2,839,547  | 293,453    | 10.3%          |
| Member Payables                        | 501,278            | 528,358    | (27,080)   | -5.1%          |
| Patron and Pool Liabilities            | 1,532,544          | 1,341,910  | 190,634    | 14.2%          |
| Other Current Liabilities              | 1,417,321          | 1,334,457  | 82,865     | 6.2%           |
| Total Current Liabilities              | 8,716,821          | 8,424,825  | 291,996    | 3.5%           |
| <b>Long-Term Debt</b>                  |                    |            |            |                |
| Less Current Portion                   | 4,949,874          | 5,084,611  | (134,737)  | -2.6%          |
| Other Liabilities and Deferred Credits | 1,130,702          | 1,045,426  | 85,276     | 8.2%           |
| Total Noncurrent Liabilities           | 6,080,576          | 6,130,037  | (49,461)   | -0.8%          |
| Total Liabilities                      | 14,797,397         | 14,554,862 | 242,535    | 1.7%           |
| Minority Interest                      | 924,098            | 769,413    | 154,685    | 20.1%          |
| <b>Member Equity</b>                   |                    |            |            |                |
| Preferred Stock                        | 1,631,929          | 1,531,343  | 100,586    | 6.6%           |
| Common Stock                           | 178,859            | 164,428    | 14,431     | 8.8%           |
| Equity Certificates and Credits        | 6,108,943          | 5,976,173  | 132,770    | 2.2%           |
| Unallocated Capital                    | 1,119,382          | 1,020,721  | 98,661     | 9.7%           |
| Total Equity                           | 9,039,113          | 8,692,665  | 346,448    | 4.0%           |
| Total Liabilities and Equity           | 24,760,608         | 24,016,940 | 743,668    | 3.1%           |

Low interest rates, coupled with falling debt, pushed interest expense for the top 100 co-ops to its lowest level since 1994. Interest expense fell 12 percent, to \$442 million. However, most of this decline can be traced to one cooperative which underwent major restructuring. Without that cooperative, overall debt levels would be higher. There was also a slight increase in interest expense of \$1 million.

Lower interest rates caused interest income to fall 24.9 percent, to \$27 million. Nearly all commodity sectors experienced falling interest revenue. Other income, indirectly related to operations, was also down 6.5 percent, to \$335 million. However, interest and other income generally accounts for less than 1 percent of total revenue for all top 100 cooperative.

Other expenses not directly related to operations were up 54.3 percent in 2003, to \$113 million. This is the largest amount of indirect expenses for the top 100 co-ops in the past 10 years.

Income taxes paid jumped nearly 200 percent, to \$49 million.

Non-operating expenses were down 79.5 percent, to \$35 million. These expenses are caused by accounting changes, extraordinary gains and losses, as well as income and expenses from other marginal interests. These expenses and revenues are generally non-reoccurring.

### **Co-ops build asset value**

Total assets for the 100 largest agriculture cooperatives were up 3.1 percent, to \$24.7 billion (table 2) in 2003. Leading the increase were current assets, which jumped 7.3 percent, to \$11.9 billion. Investments dropped slightly, falling .2 percent, to \$3.6 billion. Fixed assets also slipped marginally, from \$7.1 billion to \$7 billion.

The largest increase in current assets was in cash balances. Cash jumped 47 percent, to \$980 million. Higher net margins from operations helped fuel the increase in cash balances, with almost all commodity groups having higher cash balances at

the end of 2003. The exception was rice cooperatives, which used the higher cash flow generated by operations to pay off debt.

Investments in other cooperatives, excluding cooperative banks, was up 1.9 percent, to \$1.5 billion. Most of the investments in other cooperatives reside with diversified, farm supply, grain and poultry/livestock cooperatives. Investment in cooperative banks was down 4.6 percent, to \$57 million. Cooperatives carried less debt in 2003, especially from cooperative banks. Non-cooperative business investment was down 1.2 percent, to \$1.8 billion. Most of these investments (63.7 percent) were held by dairy cooperatives.

The value of fixed assets fell 1.9 percent, to \$7 billion, continuing a trend that started in 2001. However, much of the decline in 2003 can be attributed to one cooperative which sold off substantial amounts of its fixed-asset base. The average value of fixed assets purchased was up \$253,000 from 2002, to \$8.5 million.

Despite overall lower debt levels, total liabilities were up 1.7 percent, to \$14.8 billion. The increase in liabilities was due mostly to higher current liabilities, which jumped 3.5 percent, to \$8.7 billion. An increase in accounts payable and liabilities owed to members fed the increase in current liabilities. Accounts payable jumped \$293 million, to \$3.1 billion, and funds owed to patrons were up \$164 million, to \$2 billion. Total funds owed to members included member payables and other liabilities owed to patrons.

Working capital loans were down 10.4 percent, to \$2.1 billion, the lowest level in more than 10 years. Diversified cooperatives accounted for the majority of the decline, with loan value falling \$333 million.

### **More cash flow from operations**

Cooperatives were able to generate higher levels of cash flow from operations, allowing them to rely less on working capital loans. The increase in accounts payable and funds owed to

members are more likely in response to higher sales. The ratio of these liabilities to cost of goods sold remained steady, at around 9.7 percent.

Non-current liabilities fell .8 percent, to \$6.1 billion. Again, lower debt levels were the driving force. Total long-term debt, less current portion owed, was down 2.6 percent, to \$4.9 billion. Generally, this decline can be traced to lower investments in fixed assets. However, higher margins, along with higher cash balances, gave many cooperatives flexibility to pay down outstanding balances without acquiring new loans.

Eighteen top 100 cooperatives held majority holdings in subsidiaries in 2003. The top 100's minority interest in subsidiaries was up 20.1 percent, to \$924 million. Most of the minority interest is concentrated in the dairy sector, with dairy cooperatives holding more than 51 percent of the total. Diversified and sugar cooperatives hold 45 percent of the other minority interest. Each of those sectors increased the amount of minority interest.

### **Stronger equity position**

Cooperatives' improved their equity position in 2003, continuing the trend of the past few years. Total equity grew 4 percent, to \$9 billion. Total equity allocated to members grew \$248 million, to \$7.9 billion.

Unallocated equity increased 9.7 percent, to \$1.1 billion. The increase in unallocated equity reversed a declining trend of the past five years.

Diversified co-ops led the increase in equity. Their equity balance climbed \$175 million, to \$2.4 billion. Dairy and grain cooperatives among the top 100 also increased their equity balance by \$76 million each.

The dairy sector placed most of its increase in unallocated equity accounts, while grain cooperatives allocated a majority of income back to members in the form of equity credits. Poultry/livestock cooperatives were the only commodity group to suffer a decline in total equity. ■



# Measuring top 100 co-op performance

By David Chesnick  
USDA Rural Development



We can take a closer look at what the numbers in the preceding article (page 25) reveal about the financial performance of the nation's 100 largest agricultural cooperatives by using table 1 (page 29). In this analysis, average performance measurements are used.

This "averaging" will, in effect, lower the influence of the largest cooperatives of the top 100 and reflect less "swing" between commodity groups. The average ratio generated gives equal weight to all cooperatives and provides an additional perspective on the performance of the nation's largest farmer cooperatives.

Average liquidity rose in 2003 for the largest cooperatives. While the average current ratio for all the top 100 edged up from 1.37 in 2002 to 1.38 in 2003, the average quick ratio jumped from .74 to .78. This indicates better inventory control by cooperatives. An increase in cash balances helped reduce the amount of debt and reliance on outside sources for working capital.

However, not all commodity groups were able to generate higher liquidity. The better performers were concentrated among diversified and poultry/livestock cooperatives, which showed a tremendous increase in both their average current and quick ratios. Both commodity groups showed a broad decrease in debt and an increase in cash balances.

On the other hand, cotton cooperatives had a build-up of inventory. This

inventory appears to be financed mostly by working capital loans, since there was a net outflow of cash from operations. Thus, the average liquidity ratios for cotton cooperatives were down.

Leverage ratios examine the use of debt. One of the most important is the debt-to-assets ratio, which illustrates outside ownership in a business' assets. The average debt-to-asset ratio for the top 100 co-ops remained fairly stagnant in 2003, at 61.4 percent.

The highest leveraged commodity groups were sugar, poultry/livestock and diversified, with ratios of more than 65 percent. The least leveraged commodity groups were cotton and rice cooperatives. Rice cooperatives had a debt-to-asset ratio of 47.5 percent, the only group to have a debt-to-asset ratio of less than 50 percent.

## Long-term debt-to-equity falls, but still too high

Long-term debt-to-equity examines the long-term stability of a business. The average long-term debt-to-equity ratio fell from .87 to .78 in 2003. This signals less reliance on debt and more equity for long-term financing.

However, a long-term debt-to-equity ratio of .78 is still relatively high compared to the ratio between .5 and .6 recorded from 1999 to 2001. Cotton and rice cooperatives do not use much long-term debt in their capital structure.

Due to a reorganization of one cooperative, the fruit/vegetable group saw its average long-term debt-to-equity ratio decline from 2.74 to .65. Excluding that one cooperative, the average ratio still improved, from .75 to .69.

Poultry/livestock had a tremendous jump, from 3.12 to 7.20 in average long-term debt-to-equity. Much of this jump resulted from a transfer of short-term to long-term debt. Sugar cooperatives are also highly leveraged, with an average long-term debt-to-equity ratio of 1.18.

Being leveraged, in and of itself, isn't a problem. It becomes a problem when the operations do not generate enough margins to cover interest expense, resulting in default on the loans.

Times-interest-earned is a ratio that looks at how many times margins can cover interest expense. In 2003, the largest agriculture cooperatives had an average times-interest-earned ratio of 12.45, down from 14.32 in 2002. Much of this decline can be attributed to the dairy sector. However, the dairy cooperatives fall from an average of 68.06 to 56.27 in 2003 should not be a cause for concern.

What may be a cause of concern for some sugar and poultry/livestock co-ops is having both low times-interest-earned values and high long-term debt-to-equity values. Poultry/livestock cooperatives had an average ratio of .72 while sugar co-ops had a ratio of 2.14. On a positive note, sugar cooperatives have shown improvement on this score in each of the past five years.

Efficiency ratios examine how a business uses its assets to generate sales. The average local asset turnover for the top 100 increased from 3.10 to 3.14 times in 2003. Most of the commodity groups had a ratio of between 2 and 3. Cotton, dairy and sugar co-ops were the exception. Both cotton and dairy cooperatives had a declining local-asset-turnover ratio. However, both

were above the average.

Cotton cooperatives fell from 4.69 to 3.91 and dairy cooperatives fell from 6.01 to 5.49. Sugar cooperatives operate in a heavily capitalized industry, so their turnover ratios reflect this with average lower values. This will be more evident in their fixed-asset-turnover ratio. The average total-asset-turnover for sugar cooperatives was .96 in 2003.

The average fixed-asset turnover for all of the top 100 was up slightly from 2002, from 14.57 to 14.66. Most commodity groups had a turnover rate that ranged from 10 to 15 times. The more processing a cooperative performed, generally the lower the turnover rate.

As mentioned earlier, sugar cooperatives are highly capitalized and their average fixed-asset turnover was 1.92 in 2003. Despite the low value, they showed a strong improvement from 2002, when the ratio was 1.75. Other commodity groups which do less processing — such as poultry/livestock cooperatives — have higher fixed asset

turnover ratios. In 2003, poultry/livestock co-op turnover ratio was 31.43, up from 30.30 in 2002.

Dairy cooperatives also had a high turnover value of 29.21 in 2003.

However, there was a high variation level between dairy cooperatives, which ranged from a high of 175.28 times to a low of 4.83 times.

### Gross margins reflect pricing strategy

While most cooperatives do not have profit as their primary objective, they still must generate margins in order to continue operations. Profitability ratio trends indicate whether a cooperative is headed for failure.

Gross margin percent generally measures pricing strategy of the cooperative. In other words, it looks at margins generated after the cost of goods sold is subtracted from total operating revenues. If a marketing cooperative is paying too much to its members up front for their commodities, the gross

margins left may not be enough to cover expenses. So, looking at changes in gross margins as a percent of total revenue can help determine a co-op's pricing strategy.

The average gross margin percent for the largest agriculture cooperatives in 2003 was 14.29. This value has been declining steadily from a high in 1999 of 16.48. Most of the commodity groups tend to have a ratio between 10 and 20. However, co-ops that perform more processing tend to generate higher expenses and will require higher gross margins to cover those expenses.

Changes in gross margin percent are only half the story. If cooperatives are becoming more efficient in their operations by lowering operating expenses, they will not need higher gross margins. Therefore, members can benefit directly on the front end by receiving higher prices for their commodities they market through the cooperative or pay lower prices for

*continued on page 40*

**Table 1—Average selected ratios by commodity group, Top 100 Cooperatives, 2002-03**

|                   |      | Current Ratio | Quick Ratio | Debt to Assets | Long-Term Debt to Equity | Times Interest Earned | Local Assets Turnover | Fixed Assets Turnover | Inventory Turnover | A/R Turnover | Gross Profit Margin | Net Operating Margin | Return on Total Assets | Return on Members Equity |
|-------------------|------|---------------|-------------|----------------|--------------------------|-----------------------|-----------------------|-----------------------|--------------------|--------------|---------------------|----------------------|------------------------|--------------------------|
| Top 100           | 2002 | 1.37          | 0.74        | 61.27%         | 0.87                     | 14.23                 | 3.10                  | 14.57                 | 70.90              | 16.41        | 14.65%              | 1.36%                | 5.62%                  | 5.28%                    |
|                   | 2003 | 1.38          | 0.78        | 61.35%         | 0.78                     | 12.45                 | 3.14                  | 14.66                 | 46.31              | 17.41        | 14.29%              | 1.68%                | 5.98%                  | 13.09%                   |
| Cotton            | 2002 | 1.50          | 0.71        | 47.92%         | 0.28                     | 6.35                  | 4.69                  | 16.81                 | 15.01              | 23.64        | 17.72%              | 4.02%                | 10.76%                 | 18.33%                   |
|                   | 2003 | 1.44          | 0.55        | 51.84%         | 0.27                     | 6.47                  | 3.91                  | 15.36                 | 9.87               | 24.96        | 17.83%              | 4.73%                | 10.90%                 | 20.53%                   |
| Dairy             | 2002 | 1.32          | 0.95        | 59.78%         | 0.44                     | 68.06                 | 6.01                  | 32.85                 | 273.82             | 24.53        | 9.43%               | 1.26%                | 5.94%                  | 15.40%                   |
|                   | 2003 | 1.32          | 0.94        | 60.82%         | 0.41                     | 56.27                 | 5.49                  | 29.21                 | 134.43             | 22.82        | 9.55%               | 1.17%                | 4.75%                  | 10.27%                   |
| Diversified       | 2002 | 1.19          | 0.81        | 68.92%         | 0.75                     | 2.83                  | 2.02                  | 8.97                  | 11.66              | 7.40         | 12.09%              | 1.61%                | 5.73%                  | 10.74%                   |
|                   | 2003 | 1.38          | 0.93        | 68.00%         | 0.94                     | 2.66                  | 2.22                  | 9.02                  | 12.42              | 9.48         | 12.92%              | 1.43%                | 6.38%                  | 11.54%                   |
| Fruit/Vegetable   | 2002 | 1.60          | 0.72        | 68.50%         | 2.47                     | 2.69                  | 2.32                  | 10.37                 | 46.72              | 11.94        | 20.00%              | 1.52%                | 7.91%                  | -11.43%                  |
|                   | 2003 | 1.59          | 0.76        | 61.72%         | 0.65                     | 4.64                  | 2.42                  | 11.64                 | 31.96              | 12.57        | 21.17%              | 3.99%                | 13.38%                 | 38.84%                   |
| Farm Supply       | 2002 | 1.32          | 0.71        | 56.51%         | 0.44                     | 2.64                  | 2.35                  | 10.40                 | 9.47               | 10.56        | 15.99%              | 1.21%                | 4.64%                  | 6.22%                    |
|                   | 2003 | 1.31          | 0.77        | 58.15%         | 0.47                     | 3.61                  | 2.48                  | 10.94                 | 10.55              | 11.04        | 15.19%              | 1.63%                | 5.61%                  | 10.10%                   |
| Grain             | 2002 | 1.26          | 0.58        | 61.24%         | 0.40                     | 3.89                  | 2.58                  | 9.38                  | 8.95               | 18.35        | 12.71%              | 0.87%                | 4.53%                  | 8.19%                    |
|                   | 2003 | 1.26          | 0.63        | 62.58%         | 0.45                     | 2.49                  | 2.87                  | 10.58                 | 12.37              | 21.28        | 11.42%              | 0.54%                | 3.30%                  | 5.63%                    |
| Poultry/Livestock | 2002 | 1.77          | 1.34        | 65.78%         | 3.12                     | 1.08                  | 2.78                  | 30.30                 | 217.50             | 13.85        | 7.99%               | 2.23%                | 4.95%                  | -25.44%                  |
|                   | 2003 | 2.14          | 1.70        | 68.28%         | 7.20                     | 0.72                  | 2.92                  | 31.43                 | 251.70             | 13.31        | 7.58%               | 0.56%                | 2.69%                  | 1.58%                    |
| Rice              | 2002 | 1.67          | 1.03        | 50.42%         | 0.38                     | 7.87                  | 2.26                  | 4.92                  | 11.37              | 10.31        | 34.00%              | 2.86%                | 7.62%                  | 14.30%                   |
|                   | 2003 | 1.69          | 0.76        | 47.46%         | 0.38                     | 9.34                  | 2.44                  | 5.34                  | 9.28               | 12.39        | 36.11%              | 4.19%                | 10.89%                 | 23.39%                   |
| Sugar             | 2002 | 1.35          | 0.60        | 65.33%         | 1.17                     | 1.55                  | 0.94                  | 1.75                  | 5.79               | 10.05        | 26.18%              | 2.28%                | 4.83%                  | 5.39%                    |
|                   | 2003 | 1.35          | 0.59        | 66.62%         | 1.18                     | 2.14                  | 0.96                  | 1.92                  | 5.74               | 9.83         | 25.41%              | 3.19%                | 5.62%                  | 8.42%                    |





# Perils & Pleasures of Partnerships

*Key issue for co-ops in business partnerships: who do you trust?*

**By Kimberly Zeuli,  
Assistant Professor  
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University of Wisconsin-Madison**

*Editor's note: This is the second of three articles with highlights from the seventh annual Farmer Cooperatives Conference, Cooperative Innovation, held last fall in Kansas City. Part I appeared in the Jan–Feb. 2005 issue. Part III will appear in the May–June issue.*

**P**artnerships are businesses formed when two or more companies or people join forces to accomplish more collectively than they can

individually. According to Roger Ginder, a professor at Iowa State University, there are three general types of partnerships:

- (1) Horizontal partnerships (both firms are at the same level in the value chain); Example: Agriliance, an agronomy partnership between two regional cooperatives, Land O'Lakes Inc. and CHS Inc.
- (2) Vertical partnerships (firms that are at different levels in the value chain); Example: Land O'Lakes partnering with local co-ops to build jointly owned feed mills.
- (3) Complementary joint venture with a firm outside the value chain; Example:

West Central Co-op's joint venture with Todd & Sargent, a corporate construction firm, to form the Renewable Energy Group (REG), which builds turn-key biodiesel plants and provides start-up assistance and ongoing plant management for clients.

Ginder says that horizontal partnerships between cooperatives and investor-owned firms (IOFs) are one of the most challenging partnerships to establish and maintain. Two different examples — with two very different outcomes — of local cooperatives entering into a partnership with Cargill were presented at the *Cooperative Innovation* conference.

## **Ag Partners LLC**

Troy Upah, CEO of Ag Partners LLC, described the creation and success of his firm, a partnership equally owned by Albert City Elevator, an Iowa farm supply and grain co-op established in 1905, and Cargill. The two partners felt that a joint venture would improve their value to local farmers, improve efficiencies and allow them to update facilities they operated in an overlapping trade area.

Albert City brought nine grain, agronomy and feed facilities and 900 farmer-members to the partnership; Cargill brought four similar facilities to the partnership. In 1997, the two businesses agreed to a five-year partnership. Instead of updating some of the current dry fertilizer facilities, the two compa-

*Global Berry Farms is a marketing partnership that provides services to co-ops producing blueberries, strawberries, blackberries and raspberries. Photos courtesy Global Berry Farms*

nies built a new, 15,000 ton dry plant to take the place of five smaller plants. This saved \$1 million that would have been needed to upgrade the older and smaller facilities.

The two partners operate autonomously, with Ag Partners LLC having decision-making power and exerting influence on budget and strategic planning. Upah cautioned that the decision-making process for the partnership, however, has to be both business-centered and sensitive to local concerns. Challenges to the partnership have included initial customer concerns regarding either partner having a controlling influence, market perceptions about Ag Partners operating as a truly independent organization, and supplier misconceptions about the structure of Ag Partners (which is often misconstrued as being more of a Cargill entity instead of a separate business).

These challenges were overcome, and Ag Partners has been successful, with improved efficiency and positive financial results for both partners, Upah said. Overall, “The value of an investor-owned partnership lies in greater access to resources — including capital, risk management and marketing — than each owner would have on their own in Northwest Iowa. We also gain a very strong board of directors with industry knowledge and solid outside perspectives,” he noted.

### Agri Grain Marketing

Another Iowa partnership between a co-op and Cargill that did not work out as well is Agri Grain Marketing (AGM). Created in 1986 by AGRI Industries, a farmer-owned cooperative, and Cargill, AGM was formed to provide both partners with grain marketing and other services. The partnership went well until 2002, when problems between the partners surfaced. By 2004, the partnership dissolved.

Sue Tronchetti, a board member of AGRI Industries, described the partnership failure as the result of a shift in the business goals of both companies. “Agriculture has witnessed many

changes from 1986 through the 1990s that brought about changes in each partner’s goals,” Tronchetti said.

The major difficulty AGRI



Industries faced in ending the AGM partnership was the lack of a clear exit plan. The co-op had to decide how and when to end the partnership — which were both contentious issues. There were also considerable costs for ending the partnership.

In the end, the partnership experience with Cargill was not bad enough to prevent AGRI Industries from searching for a new partner, even another IOF. The co-op started the search by first assessing what it needed from another firm and how to create a partnership that would allow for easier exit than the Cargill partnership had.

After consulting with industry leaders and its members, AGRI Industries decided to form a partnership with Bunge North America, the North American operating arm of Bunge Ltd., a successful global grain and oilseed company. Bunge has worked extensively with cooperatives in the past.

This time, the partnership agreement included a commitment to the idea of an evolving partnership and a detailed exit strategy. As Tronchetti noted, “Always trust your partner, but prepare for the probability that the partnership may not ultimately work out.”

How do you create successful corporate partnerships? Since cooperatives will continue to rely on partnerships with other firms for a variety of strategic advantages, what should they do to ensure success? Two successful cases discussed at the conference are summarized below. Perhaps not surprisingly, the element of trust is a key issue in each.



## Global Berry Farms

Global Berry Farms LLC (GBF) has an ambitious mission for a company created just four years ago: to be the premier fresh berry supplier to North America. John Shelford, president, described how GBF has structured its relationship with three strategic partners to ensure they achieve their goal.

Michigan Blueberry Growers Association (MBGA), a 400-member marketing cooperative representing 25-30 percent of North America's cultivated blueberries, had a marketing contract with Hortifrut SA, dating back to 1991. Hortifrut is a closely held family corporation representing 30-35 percent of all berry production in Chile (raspberries, blueberries and blackberries) and 40 percent of Mexico's fresh blackberry production. In 2002, Naturipe Berry Growers, a California marketing cooperative founded in 1917 that represents 8-10 percent of California's fresh strawberry sales, became an equal partner.

The three organizations formed a partnership called Global Berry Farms LLC, with MBGA, Hortifrut and Naturipe each holding an equal, 33.3 percent interest.

GBF sales have increased from \$72 million in 2001 to a forecasted \$214 million in 2005. Although it does some non-partner business, it tries to keep partner-sourced sales around 90 percent of its volume. The partnership can provide year-round fruit supplies to customers who are no longer satisfied with having to source fruit from multiple, seasonal suppliers. In addition, its fruit volume is sufficient to mount a serious marketing campaign.

The partnership has not been without its challenges. MBGA and Hortifrut enjoyed a nine-year relationship; however, neither had any prior relationship with Naturipe. Therefore, trust and confidence had to be built in the years following Naturipe becoming a partner. Since fruit prices are calculated daily, trust is essential.

Perhaps more importantly, each of the partners had pride in, and an emo-

tional connection to, the success of their own operations. This pride was difficult to put aside when they eventually agreed to adopt the Naturipe brand. As Shelford put it, "the Naturipe brand was almost a deal breaker."

How did they overcome these chal-

*Keys to successful partnerships: (1) strategic considerations for partnerships must be compelling; (2) partners must be willing to invest an inordinate amount of effort into relationship building; (3) communicate the partnership's vision often; and (4) always deliver on promises.*

lenges? Two of the partners had a track record which, Shelford acknowledged, had a "huge impact on working together." Shelford had also worked 18 years at MBGA.

To build trust among the partners, MBGA established an intensive agenda of membership meetings and sent its board to Chile to learn more about

Hortifrut. Board members also traveled to California to learn more about Naturipe. Employees were integrated into a new team at GBF, which experienced very little turnover.

Each partner has two representatives (their CEO and their board's designated representative) on the GBF board. All decisions must be unanimous. Shelford admits that he was skeptical of this policy at first, but now endorses it wholeheartedly. He feels that creating a united front is key to their partnership.

Expenses are allocated based on a fixed and variable basis to ensure equitability. The partners work together to develop their supplies.

Shelford offered this advice for successful partnerships: (1) the strategic considerations for a partnership must be compelling; (2) the partners must be willing to invest an inordinate amount of effort into relationship building; (3) they should communicate the partnership's vision often; and (4) always deliver on promises.

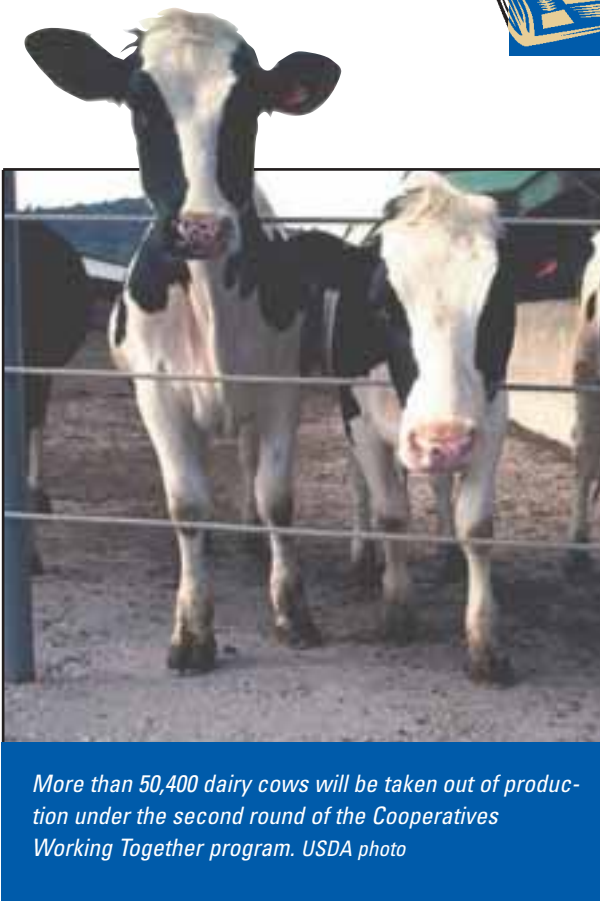
## Dairy Marketing Services

Rick Smith, CEO of Dairyalea Cooperative Inc. and chief operating officer of Dairy Farmers of America (DFA) came to the dairy industry after briefly working as a teacher and then as a lawyer — both careers providing a unique perspective which he believes has served his organization well.

In 1999, after years of intense competition among dairy co-ops in the Northeast, Dairyalea and the then-newly formed Dairy Farmers of America (DFA) — decided to pool resources to create Dairy Marketing Services (DMS) as a larger, more effective marketing organization for the Northeast.

Today, DMS is a partnership among three major co-ops (DFA, Dairyalea, and St. Albans Cooperative Creamery), and has relationships with Land O' Lakes, many small co-ops and 2,000 independent dairy producers. Smith said this diversity of owners is the strength of the operation.

*continued on page 37*



More than 50,400 dairy cows will be taken out of production under the second round of the Cooperatives Working Together program. USDA photo

## CWT Round II removing nearly 1-billion pounds of milk

Cooperatives Working Together (CWT) — a dairy industry funded and administered program to help better balance milk supply and demand — has accepted bids from 363 farms to retire their dairy herds. These bids represent 50,478 dairy cows, all of which will be sold by the participating farmers for beef. The cows being retired produced 908 million pounds of milk annually, or a little more than 0.5 percent of the 170 billion pounds of U.S. milk produced in 2004.

“Our field auditors visited each of the 378 farms we initially accepted into the program,” says Jerry Kozak, president and CEO of National Milk Producers Federation, which manages CWT. “We had excellent cooperation from all the farmers, which allowed us to complete our auditing process ahead of schedule. That process screened out a small number of bids that, it turned out, didn’t meet our program’s criteria.”

The average bid accepted in the second herd retirement program was \$5.24/cwt, with no bid accepted above \$7.63. The 363 accepted bids were selected from 736 submitted. The 908 million pounds of milk removed is 4 percent higher than CWT’s initial goal of 870 million pounds. In the first herd retirement program in the fall of 2003, CWT accepted bids from 299 farms that retired 33,000 cows representing 608 million pounds of milk.

“This program is a win-win for all of America’s dairy producers,” Kozak says. “Producers who wished to retire their herds are able to do so through a bidding process that assures they receive fair market value for their milk production capacity, while those dairy farmers who remain in business will benefit because of a better balance between supply and demand.” Under CWT, farmers bid to be paid for the volume of milk that their herds produced, and also recover the market price for those herds when sold for beef.

## Southern States Co-op acquires Agway’s share of Co-op Milling

Southern States Cooperative Inc. (SSC) is now the sole owner of Cooperative Milling in Gettysburg, Pa., following its acquisition of the 50-percent interest Agway had held in the business. The milling business produces premium horse feeds under the Triple Crown and Legends brands, as well as other livestock feeds. SSC plans

to expand distribution of the mill’s feed into New York and Connecticut.

Agway is now defunct, having declared bankruptcy in 2002, while SSC has been making marked progress in restoring its operations back to fiscal health after several years of losses. Southern States has 300,000 members and serves nearly 1,200 retail outlets in 19 states with agricultural inputs and farm and home products.

## Bio-energy priority for USDA value-added grants

Agriculture Secretary Mike Johanns has announced the availability of \$14.3 million in grants that will support the development of value-added agriculture business ventures and support President Bush’s energy plan to develop alternative sources of renewable energy. “The Bush Administration is committed to working with rural farmers, ranchers and entrepreneurs to increase their economic opportunities, and to create jobs that boost local economies,” says Johanns. “These grants provide America’s farmers and ranchers with the investment funds needed to expand their role in developing and marketing value-added products.”

Priority consideration will be given to those grant applications that have at least 51 percent of project costs dedicated to activities for a bio-energy project. The renewable energy projects involve biodiesel, ethanol or wind energy production or the use of biomass to generate energy. The funds are provided through the Value-Added Producer Grant program, administered by USDA Rural Development. Grants are available to independent producers, agricultural producer groups, farmer or rancher cooperatives and majority-



controlled producer-based business ventures. They may be used to: (1) fund planning activities needed to establish a viable value-added marketing opportunity for an agricultural product (e.g. conduct a feasibility study, develop a business plan, develop a marketing plan), or (2) acquire working capital to operate a value-added business venture that will allow producers to better compete in domestic and international markets.

Awards will be made on a competitive basis. Applications must be received no later than May 6, 2005. For more details about application and program requirements, visit: <http://www.rurdev.usda.gov/rbs/coops/vadg.htm>, or call (202) 690-2426.

### **DFA acquires Keller's Creamery**

The producer-owners of Dairy Farmers of America Inc. (DFA) have acquired all of the ownership interests in Keller's Creamery LP, the nation's second largest manufacturer of butter for retail, food service and industrial uses. Terms of the deal were not announced. Keller's was formed in May of 2000 as a joint venture between DFA and Frank Otis and Glenn Millar, the former management team of Sodiaal North America Corporation (although dairy products have been produced under the Keller's brand for more than a century). With this transaction, DFA becomes the majority owner of the partnership in the butter business and will oversee the management of Keller's warehouse and office operations in Harleysville, Pa., and the butter processing plant in Winnsboro, Texas.

"For the past four years, our dairy farm families have helped to supply milk and cream that goes into Keller's butter churns," says Gary Hanman, DFA's president and CEO. "This transaction doesn't really change the operations, except it creates an even stronger relationship between our farmers and the butter brands. It also provides opportunities for future efficiencies and market synergies among our processing units."

In 2003, the Winnsboro, Texas, plant churned cream into more than 100 million pounds of dairy products, including premium and bulk butter, butter oil, non-fat dry milk powder and other dairy ingredients. Mark Korsmeyer, president of DFA's American Dairy Brands (ADB) division, will assume managerial responsibilities for Keller's marketing, sales and manufacturing functions. ADB is the retail brand division of DFA's manufacturing group, which markets processed and natural cheese, as well as formulat-



ed, dairy-based beverages under DFA's regional and national product brands including: Borden cheese, Cache Valley cheese, Sport Shake, Sport Shake Max and VitalCal.

### **Health care co-ops get boost in Wis., Minn.**

President George Bush in December made official the \$2.25 million earmarked for Co-op Care, the project developed by Wisconsin Federation of Cooperatives (WFC) and Minnesota Association of Cooperatives (MAC) to increase access to affordable health benefit plans. The funds will be used for establishment and administration of a "stop loss fund" that will help diminish the high-risk label that insurers have attached to many farmers and small business owners.

"We are very pleased Co-op Care was among the projects funded," said Bill Oemichen, WFC President and CEO. "The funds will help pay for some of the higher-cost claims incurred by cooperative members, which will in turn help stabilize premium rates over a number of years, a priority of the Co-op Care project."

In related news, WFC and MAC members gave their overwhelming

approval to unification of the two organizations. The action was taken at the joint annual meeting of the organizations held in November.

### **LO'L sales top \$7.7 billion; CEO Jack Gherty to retire**

Land O'Lakes reported \$7.7 billion in sales for 2004, up sharply from \$6.3 billion in 2003. But net earnings of \$21 million were down from \$82 million in 2003. The co-op returned \$35 million in cash to members in 2004, up from \$24 million in 2003, boosting the co-op's five-year cash payout to members to \$198 million.

Land O'Lakes is poised to transform itself into a farmer-owned organization that is more focused, financially stronger and positioned to deliver on the strategic and financial potential of its recent growth initiatives, President and CEO Jack Gherty told 2,000 delegates and visitors at LOL's 84th annual meeting in Minneapolis. He said LOL will focus on three key strategies in driving this transformation: building on a foundation of excellent people; accomplishing key portfolio initiatives and delivering industry-competitive results in core businesses.

"Organizations don't transform people," Gherty said. "People — the right people — transform organizations." Gherty, who has led the co-op since 1989 and been on the staff for more than 34 years, has announced that he will retire at the end of this year. The board is now in the process of selecting his successor.

Chief Financial Officer Dan Knutson said the decline in net earnings was due to a \$36.5 million charge related to the company's \$249.5 million investment in CF Industries (its joint venture fertilizer manufacturing unit) and a \$23.1 million non-cash adjustment related to hedging losses. Proceeds from litigation settlements were also \$17.4 million less in 2004 than in 2003.

"If you factor out these three items, and their tax impact, you would see net earnings of \$66.5 million from our base business in 2004, a \$13 million

increase from comparable base business performance in 2003,” said Knutson.

Land O’Lakes also continued to make progress in paying down debt and strengthening the balance sheet in 2004, Knutson said. Since the company’s acquisition of Purina Mills in 2001, total balance sheet debt is down more than \$200 million. In total, the co-op has achieved \$416 million in debt reduction over that period. He also indicated that the expected proceeds from the recently announced sale of the company’s swine business would enable further debt reduction.

The co-op saw improved earnings in the Dairy Foods, Seed, and Agronomy businesses, as well as strong performance in Layers/Eggs. Although CF Industries’ 2004 performance was strong, domestic nitrogen manufacturers remain at a considerable competitive disadvantage in today’s global market, Gherty noted. “The doubling of natural gas costs over the past few years has created considerable stress on U.S. nitrogen manufacturers,” he said. “We are engaged with the other CF owners to aggressively evaluate the strategic options to improve performance and returns.”

### Preserving rural heritage, culture goal of White House/USDA effort

Agriculture Secretary Mike Johanns marked the second anniversary of the *Preserve America* initiative by announcing that *Preserve America* communities will be given priority consideration for community facility funding projects that support efforts to preserve and encourage enjoyment of America’s priceless cultural and natural heritage.

“There are significant economic, educational and cultural benefits that historic preservation provides, especially to rural communities,” said Johanns. “Sustainable preservation is not a cost for maintaining the past, it is an investment in the future. Rural communities that are dedicated to historic preservation will be rewarded for their vision for the future, as their efforts help revitalize their local econ-

omy and sense of community pride.”

The *Preserve America* initiative, announced by First Lady Laura Bush in March 2003, is a White House effort to encourage and support community efforts to preserve America’s priceless cultural and natural heritage. The goals of the initiative include: a greater shared knowledge about the nation’s past; strengthened regional identities and local pride; increased local participation in preserving the country’s cultural and natural heritage assets and support for the economic

Secretary for Rural Development. The Community Facilities Loan and Grant program provides communities with financial tools and facilitates essential community facilities such as health care clinics, police and fire stations, schools and child care centers. The program’s flexibility also allows funding for projects that revitalize rural economies, such as interpretative centers, museums or restored historical buildings. Further information on eligibility for priority funding can be obtained by contacting any local



*This farmer’s market in downtown Ritzville, Wash., was designated a Preserve America Community in summer 2004. Located in the state’s eastern wheat belt, Ritzville (population 1,736) was settled in the late 1870s, largely by German and Russian immigrants. The turreted building is currently partly occupied by a senior center. Photo courtesy R. Bruce Eckley Photography.*

vitality of communities. To date, more than 220 communities in 37 states have received the designation as *Preserve America* communities and will be considered for priority funding under the Rural Development Community Facilities program.

“We want to provide incentives to communities to look for projects that will help rejuvenate their local economies, as well as preserve and promote our national heritage,” said Gil Gonzalez, USDA Acting Under

Secretary for Rural Development office or by visiting [www.rurdev.usda.gov](http://www.rurdev.usda.gov).

Communities designated through *Preserve America* receive national recognition for their efforts. Benefits include use of the *Preserve America* logo, listing in a government Web-based directory to showcase preservation and heritage tourism efforts, and eligibility for special existing and proposed *Preserve America* grants and funding through various government agencies. The next quarterly deadline



for *Preserve America* Community applications is June 1, 2005. For more information, application forms, and procedures, visit: [www.PreserveAmerica.gov](http://www.PreserveAmerica.gov).

### CoBank pays record patronage; smaller board approved in vote

CoBank's 2004 earnings of \$275 million climbed 5 percent from \$261 million in 2003. The increase was driven largely by a lower provision for credit losses — reflecting improved credit quality — and by lower financial assistance expenses for the Farm Credit System. The strong showing will allow the co-op bank to return \$160 million in patronage and stock retirements to customer-owners for 2004. The cash distributions represent a record 13.3-percent return on average invested capital for customer-owners. For the past five years, CoBank customer-owners have received an average of \$121 million per year in cash as a result of their investment in the bank.

Total loans and leases outstanding to U.S. and international customers declined slightly, to \$24 billion, down from \$24.8 billion in 2003. Most of the reduction can be attributed to changing market conditions and refocusing portfolio strategy with core rural customers.

“For customers, patronage remains one of the most tangible measures of our success,” Douglas D. Sims, CoBank CEO said. “In 2004, we continued to build on our history of consistent financial performance. Even though loans and leases declined slightly for 2004, capital grew, our risk profile improved and earnings increased.”

CoBank — part of the \$125 billion U.S. Farm Credit System — has enhanced its capital plan for 2004 by increasing the overall rate at which patronage is calculated and by increasing the level of cash patronage paid to stockholders. With \$30.9 billion in assets, CoBank specializes in financing for agribusinesses and Farm Credit associations, as well as rural communi-

cations, energy and water systems.

In other developments, 96 percent of the bank's stockholders recently cast votes approving bylaw changes which will reduce the size of the current 26-member board to 15 to 17 members. Existing representational districts will be combined into three regions (East, Central and West), each of which will elect four directors. The board will also include a maximum of three outside directors (who can have no customer affiliation with the bank) and two appointed directors (who may have a customer affiliation). Director terms are being expanded from three to four years.



Howard Isom



Mike Toelle

### Isom, Toelle NCFC's directors of the year

The National Council of Farmer Cooperatives (NCFC) has awarded Howard Isom, a farmer from Chico, Calif., and board chairman of Blue Diamond Growers, the Farmer Cooperative Director of the Year award for directors with 12 or more years tenure. Mike Toelle, a farmer from Browns Valley, Minn., and chairman of CHS Inc., won the award for the director with less than 12 years tenure on the board. Isom and Toelle were saluted for leading their cooperatives to meet the needs of farmer-members while positioning their co-op's to compete in a rapidly changing global marketplace.

Isom, a Blue Diamond member since 1969 and a director for 16 years, farms 1,200 acres of almonds, walnuts and grapes. He is also president of Matson and Isom, an accounting firm in Chico. Toelle, a co-op member his

entire adult life, works a 3,200-acre grain, hog and cattle operation with his family near Browns Valley. “Both Harold and Mike are dedicated to the principles of farmer-ownership and their leadership of their respective boards makes them worthy recipients of the Director of the Year award,” says Jean-Mari Peltier, president and CEO of NCFC. The awards were presented Jan. 23 at NCFC's 76th annual meeting in Carlsbad, Calif. The award was established to recognize the outstanding achievements of farmer cooperative directors who take the lead to help their boards make decisions vital to their cooperative.

### FCS America board election reflects anti-sale sentiment

Results of a board election in January for Omaha-based Farm Credit Services of America give further evidence of members dissatisfaction with a plan that would have sold the co-op lender to Rabobank had it not been scuttled by member opposition and the concern of Congress. Five directors elected to the co-op's 17-member board were all endorsed by Farmers for Farm Credit, the grassroots group that led opposition to the sale.

Myron Edelman of Watertown, S.D., chairman of Farmers for Farm Credit, which opposed the sale, said the election indicates that the cooperative's members want to stay within the national Farm Credit System, according to a report in the *Omaha World Herald*. “A strong majority of the stockholders seem to agree with our position,” Edelman said.

“Sometimes we forget, particularly in large business entities, that they still work for the owners,” Neil Harl, an Iowa State University professor, told the *World Herald*. “Sometimes the shareholders are goaded into taking matters into their hands. I think this is one of those examples.”

Incumbent board members Alan J. Steffens and James K. Geyer were defeated by Darrell Cain of Elwood, Iowa, and Larry Paulsen of Coleridge, Neb. Cain and Paulsen were nominat-

ed from the floor at the co-op's annual meeting. Incumbents Dean Chapman of Russell, Iowa, Gene Hammen of Wellman, Iowa, and Lyndon Limberg of Gary, S.D., were re-elected.

### **"Payback" new CHS feed brand**

Payback is the new 'umbrella' brand for all animal feed formulations from CHS, available through some 500 local co-ops and independent dealers in nine northern states. "With the CHS corporate name change in 2003, it was time to establish a product brand identity for animal feeds that was separate from the company name," says John Steffen, vice president for nutrition. "Our biggest challenge is reassuring dealers and producers that the formulas have not changed."

Payback products include a complete feed line for livestock, horse, swine and poultry, as well as specialty blends that were manufactured for decades by Harvest States Feeds, one of CHS' predecessor co-ops.

The process of establishing a new brand name included developing a Web-based survey sent to beef producers in six states across CHS' core trade territory. Overall, the single most

important attribute respondents said they wanted from their feed company was the commitment to help them be more profitable. The proposed Payback name ranked highest as appealing, memorable and relevant.

In other news, the CHS Foundation



has announced that it will contribute \$172,840 to CARE for Asian tsunami relief efforts. In early January, the CHS Foundation pledged an initial \$100,000 contribution and implemented a match program for CHS Inc. member cooperative locations and employees of CHS and Agriliance LLC, a CHS joint venture company.

### **Michigan cattle producers unite to pursue market opportunities**

Frustrated with the obstacles facing the beef industry and the challenges posed by bovine tuberculosis, a group of northeastern Michigan cattle producers have banded together to form

North Country Beef Producers Cooperative. The group was formed to explore new marketing opportunities, increase profitability and provide educational opportunities for members.

In addition to working to strengthen their business skills, the 40 members also are educating themselves about vaccination, animal health and nutrition, genetics and management practices for cow/calf producers as well as backgrounders and feeders. As part of this effort, they approached Michigan State University (MSU) Extension, the MSU Product Center for Agriculture and Natural Resources, and the Michigan Department of Agriculture (MDA) to explore new marketing opportunities to increase profitability.

"The biggest challenge is finding new ways to market beef," says Dave Glenn, Presque Isle County MSU Extension director. "We are looking into value-added options to increase the profitability of beef producers in northeast Michigan." Glenn is an innovation counselor with the MSU Product Center. He is working with a core group of seven of the cooperative's members to create a business

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## **Perils & pleasures of partnerships** *continued from page 32*

The business structure of DMS allows different groups of farmers to participate in a single marketing unit. "Every member can wear whatever co-op's hat they want, but they go to the market together, as one," Smith said. Individual identities are maintained, but by combining the milk supplies of independent and cooperative farms in the national marketplace for the purposes of creating efficiencies and the reduction of cost on milk assembly, field services and transportation, all dairy producers can effectively and efficiently market milk in the most profitable manner.

DMS also emphasizes transparency and candor in its business operations, which Smith considers essential for building trust among partners. The

cooperatives have worked hard to appeal to their consumers, most of whom have some history of farming and appreciate the dairy producers in the organization.

This "team approach" to jointly marketing milk has removed redundancy and reduced the cost on milk assembly, transportation and field services. Together, this has generated more revenues for sharing with all dairy producers involved. Risk management has also improved since the joint venture was created. Smith remarked, that "Any one of our cooperatives could have been the best in the market, but by working together, the prices have been elevated and the whole market is better off."

DMS has been very successful, earning praise from processors, producers and the agribusiness community as a model that has, indeed, created efficiencies in all areas as well as high premiums for producers. The co-ops are committed to keeping the Northeast dairy industry competitive through cooperation, said Smith.

There are still 63 dairy cooperatives in New York, and a fairly high percentage of farmers who do not belong to any co-op.

Smith believes that the key to successful partnerships is commitment. With the same level of commitment from all partners, he says the governance structure and other challenges will work themselves out. ■



plan and determine the best way to market beef using options that are feasible for the group. One option being considered is retained ownership — finishing the cattle rather than selling young stock — which will result in increased profitability.

“By feeding out our cattle, we don’t have to worry about as many obstacles relating to TB — this removes one obstacle facing farmers in our area,” says Marty Galbraith, a member of

the North Country Beef Producers Cooperative. “One of the problems many of the producers face is that as individuals, they don’t have sufficient cattle to attract buyers,” says veterinarian John Molesworth, the co-op’s executive director. “Forming a cooperative is one way of putting together larger groups of like kind cattle to attract buyers.” For more information about the co-op, contact Marty Galbraith at (989) 826-3793.

### Georgia Co-op Center gets boost from USDA grant

A \$266,000 grant from USDA Rural Development to the Georgia Center for Agribusiness and Economic Development will give Georgia its first statewide farm co-op development center. The new Georgia Cooperative Development Center (GCDC) will be one of 20 such centers in the United States. The GCDC will support fledgling

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## Trading on Tradition *continued from page 13*

safety, our consumers know exactly where their product comes from.”

The cooperative has taken product accountability to a high level. Numbers printed on the bottom of each can may be traced back to the farm of origin.

“We are planning to have a Web site so that consumers can see first-hand where their meat comes from,” says Uthlaut. “Consumers will be able to enter the number on the bottom of the can into the Web site and pull up information about the exact family and where the animal was raised.”

Heartland Farm Food’s philosophy is based on promising the consumer that they are getting the highest quality and safest product possible. Cattle used for the product are produced under a grower agreement that requires that all cattle are hormone-free and must meet a number of other quality standards.

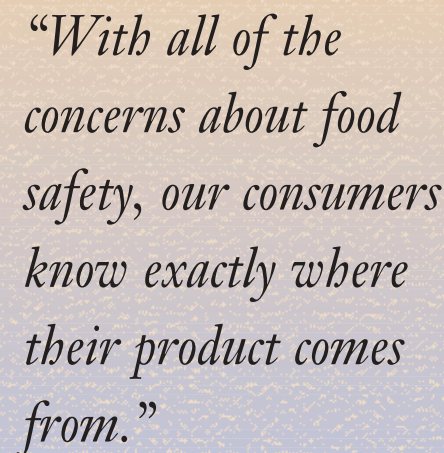
“We always told them [members] not to get involved unless they could be proud of the cattle they send,” Blaue says.

Cattle are needed throughout the year. Producers typically let Uthlaut know when they have cattle ready to be processed, and he solicits for cattle when it’s time to go into production.

Cattle are slaughtered at two nearby locations, and then brought to the Montgomery City facility to be processed. The ground and chunked beef products are fully cooked, creating a broth and separating the fat from

the beef. No additives, salts or preservatives are added to the product, making it 100 percent pure beef.

In addition to helping with in-house processing, the five employees focus on opening up new market out-



*“With all of the concerns about food safety, our consumers know exactly where their product comes from.”*

*—Jim Foster*

lets, developing recipes and general marketing strategies. A big target market is outdoor and recreational consumers. The shelf life and convenience of the product make it attractive for camping and other outdoor use.

“We want to get our product into some of the major outdoor shops, but we have to make some changes before that is possible,” says Uthlaut. “It’s definitely a high-priority market for us.”

Heartland Farm Foods ground and chunked beef products can currently be

found in super markets and specialty food stores in St. Louis and throughout east central and central Missouri.

### Expanding product line

Bill Diechman, board treasurer, says that members have been pleased with the progress thus far, but he adds that this is just the beginning for Heartland Farm Foods.

“The members have continually expressed their support of the plans and facilities,” says Diechman. “We keep in touch with the members through newsletters and annual meetings. We’re such a small group that if a member has a question, they’ll come talk to us in town, or just come up to the facility and find out what’s going on.”

“Our members have been so patient with us, and that has been key,” says Blaue.

The group is set to release six new canned beef products this spring. The products include beef and nacho cheese dip, beef ‘n’ bean dip, taco beef, chili, chili cheese dip, and new ground beef.

“If we want to get into more markets, we’re going to have to have more products,” says Uthlaut.

The co-op is also selling steaks to local restaurants and markets packaged under the Heartland Farm Foods label. For more information, contact Uthlaut by e-mail: [muthlaut@heartlandfarmfoods.com](mailto:muthlaut@heartlandfarmfoods.com), phone (573) 564-1600, or visit the Web site: [www.heartlandfarmfoods.com](http://www.heartlandfarmfoods.com). ■

co-ops and help farmers who want to form others, says CAED coordinator John McKissick. Before the grant, he said, there weren't enough resources to meet all of the needs. The CAED is part of the University of Georgia College of Agricultural and Environmental Sciences.

"The grant will focus on cooperative development and providing more services to those in agriculture who think they have a future to develop as a

co-op," McKissick said. It will fund two business development specialists and other resources. The CAED has played a key role in successful co-ops such as Sunbelt Goat Producers in Washington County and Farm Fresh Tattnall, a co-op of roadside markets and pick-your-own farms in Tattnall County.

The new center's steering committee has already approved new feasibility studies, board training, market an-

alyses, business plans or other support for four co-ops: an ethanol production co-op of Georgia corn growers; the Sunbelt Organic Gold co-op of south Georgia poultry growers who want to make and market organic fertilizer from chicken litter; a community food network that would match organic produce growers with markets in suburban Atlanta, and a co-op that would match organic markets with grass-finished beef.

## Farmer co-op business volume

*continued from page 11*

Farm numbers continue to decline, as do co-op memberships and the number of farmer cooperatives. Cooperative memberships stand at 2.7 million, down about 2 percent from 2002. Many farmers are members of more than one cooperative, hence cooperative memberships exceed U.S. farm numbers. There are now 2,982 farmer cooperatives, down from 3,140 in 2002. ■

**Table 1—U.S. farmer cooperatives, comparison of 2003 and 2002**

| Item                      | 2003              | 2002  | Change         |
|---------------------------|-------------------|-------|----------------|
|                           | <i>Billion \$</i> |       | <i>Percent</i> |
| <b>Sales</b>              |                   |       |                |
| Marketing                 | 79.6              | 76.6  | 3.90           |
| Farm supplies             | 33.9              | 31.5  | 7.54           |
| Service                   | 3.4               | 3.4   | 0.84           |
| Total                     | 116.9             | 111.6 | 4.84           |
| <b>Balance sheet</b>      |                   |       |                |
| Assets                    | 47.8              | 47.5  | 0.68           |
| Liabilities               | 27.8              | 27.9  | -0.29          |
| Equity                    | 20.0              | 19.6  | 2.04           |
| Liabilities and net worth | 47.8              | 47.5  | 0.68           |
| <b>Income Statement</b>   |                   |       |                |
| Sales                     | 116.9             | 111.6 | 4.84           |
| Patronage income          | 0.1               | 0.4   | -78.15         |
| Net income before taxes   | 1.4               | 1.2   | 17.60          |
| <i>Thousand</i>           |                   |       |                |
| <b>Employees</b>          |                   |       |                |
| Full-time                 | 163.5             | 166.1 | -1.55          |
| Part-time, seasonal       | 59.3              | 54.3  | 9.26           |
| Total                     | 222.8             | 220.4 | 1.11           |
| <i>Million</i>            |                   |       |                |
| Membership                | 2.7               | 2.8   | -2.02          |
| <i>Number</i>             |                   |       |                |
| Cooperatives              | 2,982             | 3,140 | -5.03          |

## Court of Preference *continued from page 23*

hopes to change for good. "The residents were enthusiastic from the start," says Warren Kramer, NCDF's director of housing development. "They demonstrated interest in exploring the co-op model as a way to secure the future of their housing in the park."

Now that residents own the park, they can begin to act on their list of repairs, something over which they had no control last year. Florence Pirrung, 66, who lives next to her three great-grandchildren, is looking forward to the benefits of owning the park with her neighbors.

"We need changes; we need speed bumps and the roads need to be resurfaced," she says. The resident board is also working on plans to cap a well, overhaul the playground and replace the old rusty mailboxes.

NCDF embraced the idea of helping mobile home park residents become cooperative park owners after witnessing the success of similar programs in California and New Hampshire. "In light of the impact that a park closing has on residents, we definitely saw the need," explains NCDF Executive Director Margaret Lund. "The cooperative ownership model has many applications in rural communities, beyond its traditional uses in agriculture, and the benefits — both financial and social — that the model brings to communities are really compelling."

City officials supported residents' efforts to purchase the park. Ultimately, the project delivers affordable homeownership to 47 households, with no public subsidy.

Cannon Falls Mayor Glen Weibel supported the project from the very beginning. He attended some of the organizing meetings to voice his support to the residents.

"I think it's fantastic," Weibel says, designating Sunrise Villa as the town's "Court of Preference."

Manufactured home park cooperative conversions are one dimension of NCDF's housing development agenda. NCDF is also actively pursuing the conversion of expiring Low Income Housing Tax Credit projects and USDA Section 515 properties into resident-owned cooperatives and is actively involved in the adaptive reuse of buildings as residential homeownership cooperatives in rural areas.

Find more information on other cooperative innovations at: [www.ncdf.coop](http://www.ncdf.coop) ■



## **GROWMARK forms alliance to offer grain-risk services**

GROWMARK has formed an alliance with Decision Commodities to deliver and develop grain-risk management products and services. GROWMARK is a regional, federated cooperative system made up of local grain and farm supply cooperatives across the Midwest. Decision Commodities provides innovative forward contracts to grain producers. The company's market-based pricing tool, Decision Contracts, provides farmers a means of protecting themselves from adverse price movements.

According to Davis Anderson, GROWMARK vice president/grain, GROWMARK member cooperatives were looking to find innovative grain/risk management products and services to help improve the profitability of their farmer-customers. "Decision Commodities has demonstrated the success of its business model working with local cooperative elevators. The partnership will accelerate the use of the company's contracts and provide a foundation for competitive success

among our member cooperatives in the area of producer risk management services," Anderson says.

As part of the partnership, new services and products will be developed through shared work and resources of GROWMARK and Decision Commodities. GROWMARK will be making an investment in Decision Commodities and will have a seat on the board of directors.

## **Soybean association joins crop insurance co-op**

The Minnesota Soybean Growers Association (MSGA) is joining with 17 farm associations to sponsor Growers National Cooperative Insurance Agency Inc. GNC provides an alternative way for MSGA members to purchase federal crop insurance. Through GNC, sponsoring associations will have a voice in providing insurance tailored to the specific needs of members. "This win-win program will lead to increased membership in MSGA and will provide an innovative way to purchase federal crop risk management tools," said Ron Jacobsen, MSGA president.

## **Co-ops have \$6-billion impact on North Dakota**

Cooperatives provide full-time employment for more than 11,000 people in North Dakota and contribute more than \$6 billion to the state's economy, a North Dakota State University official says. Researcher and professor Larry Leistritz said the study is the most comprehensive yet of North Dakota co-ops, according to a report in the *Bismark Tribune*. It looked at the economic activity of all types of co-ops, taking into account factors such as retail trade, personal income, total business activity, employment and tax revenue. North Dakota has 405 co-op businesses, most of them relating to agriculture.

## **Iowa, Illinois get new winery co-ops**

Iowa and Illinois are not usually thought of as wine-producing states, but each has a growing number of small vineyards and new cooperatives are forming to serve the growers. Two Rivers Grape and Wine Cooperative is the first farmer-owned cooperative

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## **Measuring top 100 co-op performance** *continued from page 29*

inputs. The gain in efficiencies will manifest itself in net margins. This is where net margin percent will show the other half of the picture.

The average net margin percent for the largest agriculture cooperatives was up from 1.36 in 2002 to 1.68 in 2003. Leading the increase were cotton, fruit/vegetable, rice and sugar cooperatives. Fruit/vegetable cooperatives enjoyed the largest jump in their average net margin percent, which increased from 1.52 to 3.99 in 2003. Poultry/livestock cooperatives, on average, had the largest decline, falling from 2.23 to .56 in 2003.

### **Return on assets**

The return on assets (ROA) looks at net margins before interest and taxes are deducted. This attempts to look at

all returns for interested parties. In 2003, ROA increased from 5.62 to 5.98 for the top 100.

Due to a major co-op reorganization, fruit/vegetable cooperatives showed a surprising jump in their ROA, increasing from 7.91 to 13.38. Cotton and rice cooperatives also had ROA of over 10 percent in 2003. All other commodity groups had ROA between 5 and 6 percent. Poultry/livestock cooperatives were an exception, with ROA falling from 4.95 percent in 2002 to 2.69 percent in 2003.

Return on member equity (ROME) measures returns attributed only to equity investment. This excludes interest and taxes from net margins. The difference between ROA and ROME illustrates the benefit or curse

of leverage. ROME for the top 100 co-ops jumped from 5.28 percent, to 13.09 percent.

With the exception of dairy and grain cooperatives, all other commodity groups shared in the higher returns to their members in 2003. The largest increase in ROME occurred in the fruit/vegetable and poultry/livestock cooperatives. In 2002, both of these commodity groups had a negative ROME while both had positive ROME in 2003. Fruit/vegetable cooperatives had the most dramatic increase, jumping from -11.43 percent to 38.84 percent in 2003. Declining values were felt in both the dairy and grain commodity groups in 2003. ■

— By Dave Chesnick,

USDA Rural Development

making wine and growing grapes in Iowa, according to the *Des Moines Register*. The new winery is one of about a dozen planning to open soon in Iowa. It is more evidence, say Iowa wine boosters, that the state is undergoing a rebirth of an industry that was all but wiped out by Prohibition and other factors.

“The wine industry is growing so fast, I’m having trouble keeping up,” White, of the Iowa State University

Extension, told the *Register*: “It is going to happen in Iowa.” Iowa now has about 30 wineries that sold about 76,000 gallons of wine in 2003. More than half of Iowa-produced wines are made in the Amana Colonies.

Meanwhile, a new winery co-op has also been formed in Illinois, with 11 small vineyards as members. Shawnee Winery Co-op is producing eight wines for its members, whose vineyards range in size from half an acre to eight acres. About \$300,000 in state and federal grants helped to launch the co-op. It has a 4,000-square-foot building that includes a production area and a wine tasting and retail area.

A 2003 study of Missouri’s wine industry shows that the state’s 47 wineries have a significant effect in stimulating rural economies.

#### **Preliminary settlement reached in MCP lawsuit**

A preliminary settlement has been reached in a class-action lawsuit filed against five former executives of the Minnesota Corn Processors (MCP) for their role in convincing farmers to sell their ethanol and sweetener business to Archer Daniels

Midland for \$400 million in 2002. That amount was only a fraction of the true value of the business, according to farmers of the former co-op.

Although growers voted to approve the sale of MCP, which had converted into a producer-owned limited liability company by the time of the sale, many now feel they were misled by their own officers, who they allege were looking out primarily for themselves (see July/August 2004 issue of *Rural Cooperatives*, page 22, for detailed background on the MCP sale; past issues are on-line at [www.rurdev.usda.gov/rbs/pub/openmag.htm](http://www.rurdev.usda.gov/rbs/pub/openmag.htm)).

The lawsuit alleges that MCP CEO Dan Thompson and four other officers conspired in self-dealing to sell MCP for personal gain. A sixth individual is charged in the suit with alleged conspiracy and breach of financial duties. Under the settlement, the five executives would pay \$5.75 million to the farmers.

The MCP executives’ defense was weakened by a note that Thompson wrote to ADM officer Marty Andreas, in which Thompson says: “my thoughts are that I am the only person who could get them to accept a lower number.” When read in context, it is clear that Thompson meant he would work to convince farmers to take a lower price than the true value of MCP, the plaintiffs say. An editorial in the *Marshall (Minn.) Independent* called



*The Shawnee Winery Co-op in Illinois benefited from Rural Business Enterprise Grants from USDA Rural Development. Photo courtesy Shawnee Winery Co-op.*

## **Legal Corner** *continued from page 24*

purchased and leased land capable of producing mushrooms and placed deed restrictions on the titles to the land. The deed restrictions barred mushroom farming on the land, usually forever.

Justice did not challenge the Capper-Volstead status of EMMC. Rather, the department asserted in its complaint that the Capper-Volstead Act does not protect members of a cooperative who conspire to prevent independent, non-member farms from

competing with the cooperative or its members.

Under the terms of the consent decree, EMMC agreed to remove all restrictions on producing mushrooms from the deeds and to restrain from similar activity in the future. No fine or other additional punishment was levied against the association or its producer-members. Thus, EMMC members may continue to agree on prices and otherwise market their mushrooms through their cooperative.

A consent decree does not set a judicial precedent in the same way a court decision can. However, this case should put marketing associations on notice that the Justice Department may intervene when it believes a cooperative’s actions artificially reduce the acreage and facilities available to non-members to grow and market the same product as the cooperative’s members, thereby depriving consumers of the benefits of competition. ■



that hand-written note a “smoking gun” of culpability.

“We are pleased this hard fought litigation has come to an end,” the class action committee says on its Web site. “We are particularly pleased that the facts behind this merger have been fully debated. A trial and appeal of this matter presented risks and costs to both sides. The parties were well served by a conscientious and hard-working judiciary which identified the

respective strengths and weaknesses in the parties’ positions prior to trial. Based upon this meaningful settlement, it now seems time for the issues surrounding the ADM/MCP merger to come to an end.”

Notice of the settlement was sent out to about 5,000 shareholders in late February. A final hearing has been scheduled for April 12, at which time the court will approve or deny the settlement, according to attorney Robert

Moilanen, of Zimmerman-Reed PLLP in Minneapolis, legal counsel for the growers. Some farmers elected last year to opt out of the class action, and will not share in any disbursement arising from the settlement. They could, however, still pursue litigation on their own. Otherwise, if approved, members would share in the settlement based on the number of shares they owned in MCP (after attorney fees and expenses are deducted). ■

# Still MORE Stuff You Need to Know

If you're a director or manager of a cooperative, or just a co-op member interested in keeping abreast of important issues that affect your interests, these publications offer you important information.

Cooperative Information Report 49

## Shared-Services Cooperatives

Shared-service co-ops include those that provide health-care and pharmacy purchasing, or hardware marketing and wholesale supply for member entities. Brochure outlines what a shared-service co-op can do for your organization.

Cooperative Information Report 58

## Assessing Performance and Needs of Cooperative Boards of Directors

The competence of your cooperative's board of directors can mean the difference between success and failure. Find out how to identify weaknesses in your directors and take steps to improve their performance.

**NEW** Cooperative Information Report 1, Sec. 26

## Farm Marketing, Supply and Service Cooperative Historical Statistics

Cooperative Statistics from 1913 to 2002. (Available only on the Web)

## The NFO: A History of the National Farmers Organization

The story behind the movement that threw Midwestern agriculture into turmoil in the 1960s and '70s.



All Publications Free

Cooperative Information Report 57

## Understanding Cooperative Bookkeeping and Financial Statements

Learn how to stay on top of your co-op's financial situation. Explains basic accounting principles, how to keep and interpret ledgers, etc.

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# VAPG program creates rural jobs, boosts local economies

**By Peter J. Thomas, Administrator  
Business and Co-op Programs  
USDA Rural Development**

**T**he Value-Added Producer Grants (VAPG) program is a great example of the commitment USDA Rural Development has made to carrying out President Bush's agenda for building a stronger rural America. You can read about an example of a project funded by this program on page 12 and learn about funding priorities and the next application deadline on page 33 of this issue of *Rural Cooperatives*.

The VAPG program is helping to accelerate the pace of the transformation of the nation's agricultural economy to one focused on producer-owned, value-added businesses. With global competition increasing for production of crops, many producers realize that their best bet for success in the years ahead will be to move higher on the value-added chain that starts with their crops and livestock.

Since 2001, USDA Rural Development has awarded \$100 million for 584 VAPG projects. Not only does VAPG help producers generate more profits from their operations and keep that income turning over in rural communities, it also helps create jobs. For example, Value-Added Partners Inc. (VAP) received a VAPG in 2001 for \$500,000 to help market dough and

bread products made from hard red winter wheat. The co-op was originally formed by a group of producers looking for value-added processing alternatives for their hard red winter wheat. This variety is the region's major crop, preferred by producers as a consistent source of clean, high-quality wheat that



*USDA Rural Development's Peter Thomas (far right) delivers a check with financial assistance to a new turkey producers' cooperative in Hinton, Va. (see page 14).*

has above-average test weights and protein levels.

In 1999, VAP began its equity drive to purchase a site for a frozen-dough processing plant. The producer response was strong. VAP also obtained a Business and Industry Guaranteed Loan from USDA for \$7.5 million, allowing the cooperative to purchase a site in Alva, Okla.

The processing plant now produces several types of dough and bread products, including its latest addition: a frozen cinnamon roll that can be microwaved. The plant's main line produces pizza crust and can process 10,000 pounds of dough per hour. VAP has 80 full-time employees and recently launched its own trucking company to handle the shipping of its products.

Recently, we have revised the VAPG program so that it can be maximized so that more people can benefit. Because of this action, more grants will be awarded, creating more jobs and strengthening the economies of more rural communities. To echo Agriculture Secretary Mike Johanns, "the Bush Administration is committed to working with farmers, ranchers and rural entrepreneurs to increase their economic opportunities and to create jobs that boost local economies. These grants provide America's farmers and ranchers with the investment funds needed to expand their role in developing and marketing value-added products."

Rural Development is committed to providing determined leadership to increase economic opportunities and improve the quality of life for citizens living in America's rural communities. With 47 state offices and 800 field offices, we look forward to working with you to bring opportunities to you and your communities. ■



# Vital Info for Co-op Boards

Co-op board members owe it to themselves and their members to be familiar with the issues detailed in these USDA Rural Development publications.



## All Publications Free

**NEW Nominating, Electing, and Compensating Co-op Directors: CIR 63** – Originally published in *Rural Cooperatives* magazine, these three articles use examples from successful co-ops to provide suggestions for selecting members of a cooperative board of directors and maintaining a competent and effective board.

**Cooperative Business Management Functions: CIR 45, Sec. 11** – Basic information about the responsibilities and functions of co-op business managers and the boards of directors who hire them.

**Who Runs the Cooperative Business? Board of Directors: CIR 45, Sec. 5** – How a co-op board of directors oversees the management of the business.

**Cooperative Directors: Asking Necessary Questions: CIR 62** – This report guides directors in asking the right questions to invoke informative responses from managers, staff, auditors, other directors, etc. An invaluable resource for directors with limited business experience.

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- Copies of CIR 63: **Nominating , Compensating Co-op Directors**  
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