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# Rural COOPERATIVES



USDA / Rural Development

May/June 2002

Things are  
looking up at:

**VALLEY SPRINGS  
FARMERS CO-OP  
Valley Springs, SD**



## More than one way for local co-ops to grow

In a mature industry, such as agriculture, growth often occurs by purchasing assets of a competitor, or merging two or more neighboring cooperatives. But expansion can also occur through internal growth of an organization that is attendant to members' needs and performs its services at such a high level of proficiency that it attracts more business volume. There are also cases where an opportunity exists for start-ups in areas where cooperatives historically have had low market shares, or where a new industry is budding.

Our cover story on South Dakota's Valley Springs Cooperative demonstrates the tenacity of a locally owned co-op that has maintained a strong sensitivity to the needs of its member-users and a conservative balance sheet. The "can do" attitude of management and employees enables it to survive and prosper without being caught up in the philosophy that merger is the only way to solve operating problems at the local level.

In many cases, mergers can help co-ops achieve efficiencies by reducing overhead and eliminating duplication of effort. But merger is not a panacea, and an ill-conceived merger can just exaggerate the weaknesses of a co-op's component parts. As this article indicates, some locals can do just fine on their own.

When mergers do occur, rationalization of assets based on your plan of action is a key step in achieving overall efficiencies. This should be done consistent with members' service needs and the co-op's future business success. The key is pursuing ownership, control and benefits for farmers.

Growth plans require careful analysis of the business environment, including strengths and weaknesses of the cooperative. This analysis should also identify new strategies or product lines that can increase member income. Articles in this issue of *Rural Cooperatives* examine these critical issues in detail.

Steps that should be taken to secure financing for a successful value-added cooperative are discussed in the article on page 17. Careful feasibility analysis—from which a business plan is ultimately developed—is especially critical for business start-ups in industries such as ethanol, biodiesel and red meats. This process is also essential for existing cooperatives that plan to extend operations into value-added endeavors.

Beware of potential conflicts of interest that can arise in an added-value venture if your cooperative takes on investor-owned firms as partners. David Kolsrud, manager of the Corn-er Stone ethanol venture in Luverne, Minn., questions (see page 14) whether outside partners are even needed by cooperatives in most cases. If they are, how you structure your bylaws may well determine if the farmer, or the outside investor, ultimately will control the business.

The article on page 20—which focuses on key questions members should ask when their cooperatives are facing major changes—is also relevant to this question. This article discusses the distinct differences in business objectives between a cooperative and an investor-owned firm. A cooperative seeks to maximize returns to members by adding value

to and marketing their products. An investor-owned firm seeks to maximize returns to investors by paying less for the farmers' input. These differences need to be addressed head-on, including identification of an exit strategy when partnerships are formed, or when management or other elements in the cooperative propose converting the business away from operating on a cooperative basis. Recent decisions to maintain cooperative status by members of Ocean Spray and Welch Foods/National Grape Cooperative contrast sharply with a recommendation of management and the board of directors of Dakota Pasta Growers to convert to a profit-oriented, non-cooperative corporation.

Answers to USDA's 2000 statistical survey indicate the challenging environment confronting the farm economy and cooperative management throughout the country (see page 8). It is times such as these that we see the true mettle of the cooperative form of business and the role cooperatives play in representing member interests. Dynamic change in farm markets is a constant and requires an astute management team (board and management) to navigate the churning waters to keep the ship afloat and to take advantage when the door of opportunity opens.

**Randall Torgerson**, Deputy Administrator  
USDA Rural Business-Cooperative Service

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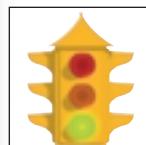
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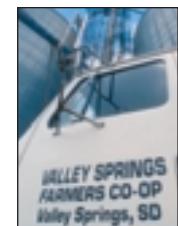
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### On the Cover:

*Expanding member business means that these silos at South Dakota's Valley Springs Farmers Cooperative will soon be bolstered by additional grain storage. This month's cover story focuses on how this local co-op has rebounded from near failure in the 1960s to become a strong and growing cooperative.*

Photo for USDA by Greg Latza



# Battening down the hatches

*Co-op security measures intensified in post-September 11 world*

**John Dewey, CF Industries Inc.**

**Sarah Schmidt, Farmland Industries Inc.**

**Gail Thuner, USDA Rural Business-Cooperative Service**

**Editor's Note:** Dewey is corporate communications manager for CF Industries, Schmidt is public relations manager for Farmland Industries and Thuner is a USDA agricultural economist.

**T**he events of Sept. 11, 2001, have forever changed the American mind set. No longer do Americans feel safe from attacks by terrorists. Feelings of shock, anguish and anger combined with a real sense of violation have led to increased security measures throughout the United States in nearly every industry.

The agricultural industry has been especially affected as concerns about the use of crop dusters and agricultural chemicals have risen to a new high. Two major cooperatives in the fertilizer industry, Farmland and CF Industries, have always been aware of potential security concerns, but both have increased their guard as security threats have become a heightened concern in a post-Sept. 11 world.

## **Farmland redoubles security efforts**

Assessing risk, planning "what-if" scenarios and protecting products from illegal use have long been routine practices for Farmland Industries. But the September 11 events, as well as the anthrax-tainted mail incidents, have generated an added security emphasis.

Before Sept. 11, Farmland's "what-if" scenarios may have dealt with a leak or accidental release of fuel or an agricultural chemical. Now Farmland considers the threat of anthrax-tainted mail or even someone flying an airplane into a fertilizer manufacturing facility to create an explosion.

Preparation will make or break the response to such an event. Scott Ast, Farmland director of worldwide security, and his team look at big-picture processes and risks. They also serve as a resource and consultant to Farmland business units and facilities. "We want to protect all the points in the process—from securing raw materials to production, storage and distribution," Ast says.



*Ralph Britt doesn't mean to be un-neighborly, but even before Sept. 11 and the subsequent anthrax attacks he had to carefully control access to his Mt. Olive, N.C., hog operation. Now livestock producers and others are being urged to be even more vigilant due to possible acts of agro-terrorism. USDA photo by Ken Hammond*

Although imagining the most elaborate "what-if" scenarios is part of the job, it is important to balance that with the most likely security breaches. According to Ast, the most prevalent illegal use of a Farmland product remains the theft of anhydrous ammonia to make methamphetamine.

Transportation is another vulnerable point in the production and distribution process. Companies such as Farmland are taking necessary precautions against theft and misuse. Farmland drivers are more aware of their surroundings and are encouraged to lock their units and park in secure areas. Farmland has also eliminated preloading of trucks.

Farmland security officials have attended a number of meetings between farm organizations and government agencies to discuss the chances of agriculture becoming a terrorism target. It recommends the following suggestions for local cooperatives.

- Know your customers and escort everyone while on your property.

- Report any suspicious attempts to purchase ammonium nitrate or urea to the FBI.
- Pay close attention to product inventories and shipments.
- Conduct a full security review of your facilities.
- Construct suitable barriers around your property, such as fencing and structures.
- Park vehicles and equipment where they can be easily seen by law enforcement during regular patrols.
- Use steel doors with deadbolt locks and bar windows where appropriate. Use high-security chains and padlocks.
- Lock vessels, containers, hoppers, tanks and equipment containing hazardous products.
- Deter vehicle ingress by using gates or bollards and chain/cable with padlocks.
- Remove hoses and use tank locks and seals for anhydrous ammonia tanks.
- Ensure security and emergency plans and procedures are in compliance with local, state and federal requirements. Conduct quarterly drills and training exercises.
- Post “Private Property-No Trespassing” signs along fence lines/boundaries.
- Keep an undated list of all emergency contacts.
- Maintain effective information technology security, password protection and firewalls.

- Report all suspicious activities, vehicles or persons around your property.
- Report all threats on personnel and facilities.
- Report all thefts, inventory shortages or missing products that could pose a public health or safety risk. Keep blank bills of lading and order forms secured. Keep seals and labels secured.
- Don’t allow loaded, unattended, unsecured trailers on your site.
- Create opening and closing security checklists for employees.
- Maintain close liaison with local law enforcement and emergency responders. Ask for extra law enforcement patrols and give them tours of your property.
- Establish a process for including neighbors and the community as part of the property security and emergency procedures.

Awareness, vigilance and common sense are all part of ensuring that ag products are used in the intended manner.

#### **CF Industries stresses around-the-clock security**

At CF Industries, new security enhancements were added to complement the company’s existing list of security systems and activities after Sept. 11. Frank Buzzanca, vice president of Environment, Health and Safety (EHS) and Engineering,

## **USDA responds to security needs**

USDA has responded in the wake of Sept. 11 by creating a new infrastructure to move forward on numerous fronts to better protect the nation’s agricultural and food systems.

Speaking at the annual meeting of the National Council of Farmer Cooperatives in Orlando in January, Jeremy Stump, a confidential assistant to Agriculture Secretary Ann Veneman, said the USDA Homeland Security Council has been created and charged with the mission of protecting American agriculture. The panel is overseen by Secretary Veneman, with Deputy Secretary James R. Moseley chairing the council. The council includes all USDA under secretaries, the inspector general, selected USDA state office directors and USDA’s communications director. The council is charged with ensuring that information, research and resources related to homeland security is shared and that USDA activities in this area are coordinated with other appropriate federal agencies.

“No effort will be spared by USDA as we work with your cooperatives and all others in agriculture to ensure the safety of the nation’s food and fiber production systems,” Stump said.

Three subcouncils have also been created to support the council’s mission in the following areas:

- Protection of Food Supply and Agricultural Production—responsibilities include protecting food production, processing, storage and distribution; rapid response to threats against the ag sector; border surveillance and protection to prevent introduction of plant and animal pests and diseases; food safety concerning meat, poultry and egg inspection, laboratory support, research and education, and outbreaks of foodborne illness.

- Protecting USDA Facilities and Other Infrastructure—responsibilities include safeguarding USDA laboratories, technical facilities, collections and information from biohazards and pathogens. Also ensures security of USDA scientists, National Forest System lands and related infrastructure and information technology resources at USDA.

- Protecting USDA Staff and Emergency Preparedness—this subcouncil deals with all issues affecting USDA staff and the continuity of operations plan, continuity of government, occupant emergency planning and federal inter-agency emergency coordination, as well as emergency communications within USDA. ■

# Homeland security: a defining issue for co-ops

"We never had to think like a terrorist before. But now we must in order to better secure our facilities from possible sabotage."

These are the words of the security director for a major farm supply cooperative (who asked that he and his co-op not be identified). They reveal much about the changed world view facing cooperatives and others in the wake of the Sept. 11 terrorist attacks.

How real is this threat of agro-terrorism? Very real, according to Dr. Peter Chalk, a senior researcher with the RAND corporation in Arlington, Va. Speaking at the annual meeting of the Farm Credit Council (FCC) in Orlando in January, Chalk said terrorists might view the nation's \$190-billion farm economy as an inviting target.

Livestock operations—such as feedlots and dairies—are especially at risk, since a pathogen introduced by a terrorist could spread rapidly through animals kept in close confinement. Chalk said one insidious aspect of agro-terrorism against livestock is that it can be difficult to differentiate between a naturally occurring disease outbreak and one caused by a terrorist.

Current methods for reporting livestock disease outbreaks need to be improved, and farmers and ag facility operators everywhere need to better plan how to protect their operations from potential sabotage, he said, adding that many livestock processing plants have only "rudimentary security systems in place."

Chalk recommended that much more be invested in

human and logistical infrastructure to better protect the nation's food production system from agro-terrorists. Other recommendations include reforming the curriculum being taught at veterinary colleges, greater involvement of state and local animal health specialists with USDA

emergency response staff, better security systems at food processing plants and more vigorous checking of seasonal workers, among others.



Peter Chalk (above) and Rep. Charles Stenholm discussed agro-terrorism at the FCC annual meeting.

## A new view

"Homeland security requires all of us to develop a new view," Minn-Dak Sugar Cooperative Chairman Victor Krabbenhoft said in his address at the co-op's most recent annual meeting in Fargo, N.D. Krabbenhoft said the impact of the terrorist attacks on America have reverberated deeply throughout all of agriculture.

American agriculture must remain strong, he said, "particularly in a world where we now know our own vulnerability to a new form of warfare—one that is fought in the shadows, one where the battle front moves at the whim of unseen foes. One day, that battlefield could well be our food supply."

Krabbenhoft warned against becoming dependent on foreign nations for vital agricultural commodities, which could be disrupted if a war or boycott suddenly cut off that supply, as occurred previously with oil.

Jim Erickson, spokesman for Southern States Cooper-

USDA photos by Dan Campbell

is the company's top security officer. "We recognize a need for heightened awareness following Sept. 11," Buzzanca said. "We've always had a strong commitment to safety and security. Now our focus must be stronger." The following list of safety and security precautions were in place at CF prior to September 11:

- 24-hour site security at terminal and plant locations.
- Fenced perimeters around facilities.
- Emergency shutdown systems that can be activated at stations located throughout the plants and ammonia terminals.
- Dikes surrounding liquid fertilizer

storage tanks to contain the product in the unlikely event of a rupture.

- Periodic inspections of all ammonia storage tanks.
- Periodic drills with local emergency responders so they are better prepared if a major incident occurred.
- Periodic EHS audits.
- Annual meetings with law enforcement to get them familiar with CF staff and facilities.
- Annual operator safety training and refresher courses.

CF has taken new steps since Sept. 11 to enhance security at its facilities. The following list provides a number of important new activities:

- Participation in a fertilizer industry security task force to share security measures being taken.
- Contacting local, state and federal agencies to discuss new security enhancements.
- Conducting security reviews and vulnerability studies at a number of facilities in 2002, in addition to the EHS audits CF already conducts.
- Anticipating unannounced visits from the U.S. Coast Guard and other government agencies that are checking to see if proper safety measures are in place. In 2001, the Coast Guard visited three CF locations and determined employees took proper security precautions.

ative, Richmond, Va., said his cooperative believes the threat is real and is thus taking steps to better secure its operations. "Before 9-11, we already had taken a number of security steps. In the aftermath, it basically was an issue of reiterating and/or putting more emphasis on what we had been

doing," he said. "For example, we already had procedures in place for recording sales of ammonium nitrate. In keeping with the FBI's request after 9-11, we added record keeping on urea sales."

Southern States also sent out guidelines for keeping fertilizer supplies, chemicals, petroleum products and rolling stock more secure—including the use of alarms at some locations. "Post 9-11, we've added alarm systems at some additional locations and maintained our emphasis on ongoing security steps."

National security and the safety of customers and their communities is the first concern for Agrilience, the fertilizer joint venture of CHS, Land O' Lakes and Farmland Industries. In the January issue of "Cooperative Partners" magazine, Agrilience CEO George Thornton says co-ops and farmers should "check your buildings, fences, lighting and locks, and provide combinations to local law enforcement officials.

"Also, re-establish contact with local law enforcement agencies that would be called in the event of product theft or tampering," he added. "Ask them to make your facilities part of their routine daily safety patrols."

Brad Gottula, Land O' Lakes Farmland Feeds director of quality assurance and regulatory compliance, makes similar suggestions. "If you transport, manufacture or store commercial feed, be vigilant for any suspicious activity and be proactive in preventing problems before

*"We now know our own vulnerability to a new form of warfare—one that is fought in the shadows..."*

they occur," he says in the article. For dairies and hog farms, limiting visitors is the first step, followed by monitoring and testing on a regular basis. Buying new animals from a known source and segregating them early on is also good advice.

#### Attacks remind U.S. of energy vulnerability

Rep. Charles Stenholm of Texas, who also addressed the Farm Credit Council annual meeting, said Americans have long believed that they have a right to cheap energy, but that the terrorist attacks should have jogged everyone into a sense of a new reality regarding energy.

"We had better recognize that we need to produce all of the energy we can, as efficiently as we can," Stenholm said. "We cannot do that with cheap oil." Ethanol, wind and solar power cannot compete with oil that sells for \$10 or \$15 per barrel, he said.

"But with \$25 oil, you will have the entrepreneurs of the world coming forward," he said.

Agriculture and the oil industry should work together, Stenholm said, adding that there is really no reason for the oil industry to oppose the development of a U.S. grain-based ethanol industry. "We need all the energy we can get," Stenholm said. "I thought we learned that in Desert Storm. We did, but it only lasted about six months.

"I was just reading a book on Osama bin Laden, written in 1999, and it's scary folks. I recommend it for every one of you. Agriculture will play a bigger role in energy production. And it is moving in that direction, but it requires some policy give and take." ■

—By Dan Campbell, editor

CF's corporate Web site has taken on a different look following Sept. 11 as well. Anything CF felt was too revealing—from a security standpoint—was taken off of its Internet site.

Employee training remains a vital component of CF's security program. CF Industries' media relations training was tested during a television reporter's surprise visit to the company's Louisiana plant. The reporter was following up on a news lead regarding reports of a suspicious vehicle in the area. While the reporter gathered information from the plant manager, the television photographer stood near a service road and prepared to set up a camera to videotape the plant. CF

security guards promptly asked the photographer for identification. The reporter later noted on the newscast that the company was doing a good job maintaining its security.

"A strong safety culture has existed at CF for a long time," said Buzzanca. "This employee mind set is deeply rooted as a result of years of training, drills, safety audits and learning from experience," Buzzanca said. "Our employees are trained to be alert at all times."

CF also communicates periodically with residents in the communities where it operates. Information about shelter-in-place is circulated in an effort to educate people on the steps to take if a major incident were to occur.

The company's public affairs office has monitored anti-terrorism initiatives discussed in Washington and at state capitols. CF will work with trade associations and regulatory agencies to ensure the safety of the fertilizer industry's infrastructure and products. The company will continue to enhance security as required to protect employees, company assets and surrounding communities.

In spite of all the new measures, though, awareness of potential threats and continued communication with the industry, the government, the community, and employees remain at the core of these cooperatives' new security programs. ■

# Trouble ahead?

*Low commodity prices, ag economy are major problems facing co-op management*

**Charles A. Kraenzle**, director, statistics

**Thomas W. Gray**, rural sociologist

USDA Rural Business-Cooperative Service

**Editor's Note:** USDA/RBS Research Report 192, "Problems and Issues Facing Farmer Cooperatives," examines more fully the various survey responses discussed in this article. It should be available by late June on the Internet at [www.rurdev.usda.gov](http://www.rurdev.usda.gov), or by calling (202) 720-8381 for a hard copy (\$5 each).

**A** USDA survey of more than 3,000 U.S. farmer cooperatives reveals that low commodity prices, the general agricultural economy, operational difficulties and increasing costs are the major problems facing cooperative management. Survey results indicate deep-seated concerns about the future viability of both cooperatives and agriculture in general.

Survey respondents were asked two open-ended questions regarding what they saw as the major problems during the past year, and what they foresee as the major problems in the next year or two. The same four major problem areas were identified by both questions, but with shifts in emphasis (see table 1).

Among the four major problem areas identified during the past year, nearly one-fifth of the responses cited low commodity prices—making it the most common response. This included low prices for cotton, cottonseed, sweet potatoes, almonds, apples, pears, fresh fruit, milk, sugar, grains and eggs.

The general agricultural economy was the second most cited problem area. A broad range of responses was included in this category, such as concern about: "the depressed farm economy," "loss of acreage and farmers," "number of dairy farmers quitting business and leaving the farm," and "producer profitability." Other responses included: "size of farms getting bigger, farmers bypassing local co-op for supplies and sales," "shrinking ag market," and "too many big farmers." As a result of the changing structure of agriculture, many said their cooperative's sales and profitability were declining.

Cooperative operational problems, cited third most frequently, included such diverse concerns as: "need for more working capital," "financing," "debt management," "equity management," "need to increase sales," "marketing issues" and "acquisition of another company and adding its operations to ours." Examples of other responses in this category included:

"working through merger," "loss of feed customers," "reducing our expenses by closing smaller branches to meet larger farmer needs more competitively," "understanding and responding to our strengths and weaknesses," and "identifying and persuading directors to pursue non-traditional income opportunities."

The fourth most often cited problem for the past year was increasing costs. Nearly one-third of the respondents mentioned the rising costs of fuel as a concern. Others mentioned increased cost of doing business because of higher costs for labor, insurance, supplies and other expenses. Examples of responses included: "rising costs, particularly for energy," "high fuel prices causing cash flow problems," "rising labor costs," "rising overhead—insurance, health insurance, utilities, etc.," "increasing costs of operations; labor, repairs, depreciation" and "construction costs."

## Problems in the near future

The same four problem areas were identified for the near future, but with the agricultural economy moving up to the top concern, followed by low commodity prices, operational difficulties, and increasing costs. The character of comments offered for near-future problems varied little from those given for the past year. Respondents may have been more hopeful for better prices in the future, but were aware that structural concerns—such as "the continuing trend toward larger farmers," "lack of production (in local areas)," and the increasing integration of multinational agribusinesses—were likely to continue to be problems in the near future.

There was less frequent concern with prices and



the weather, more frequent acknowledgment of major structural difficulties of the agricultural economy, and greater concern about competition. However, problem areas identified as difficult during the past year—low commodity prices, agricultural economy, operational difficulties, increasing costs, labor, low margins, competition and weather—continued to be cited as future concerns.

### Influence of co-op function

Whether a cooperative was primarily involved in marketing, or providing farm supplies or service had an impact on which problems were cited most often. Marketing cooperatives more frequently cited operational difficulties and competition as concerns. In the context of low prices and declining numbers of farmers and production, marketing cooperatives may plan to expand sales and markets, recruit new and larger members, or—at a minimum—maintain current market share.

Intense competition from larger organizations may make these plans difficult and raise various other operational issues for future survival.

As did marketing cooperatives, farm supply cooperatives frequently identified “the agricultural economy” as well as “low commodity prices” as major problems. However, farm supply cooperatives more frequently identified “low margins,” rather than “operational and competitive” concerns. With farmers going out of business, low prices, and farmers not being able to pay bills, many farm supply cooperatives may not be able to maintain margins. Responses from supply cooperatives cited: “loss of sales, lack of earnings in the agricultural industry and high cost of products for resale.”

Service cooperatives identified low prices, increasing costs and weather as major problems. These cooperatives are likely more affected by weather concerns than are marketing and farm supply cooperatives. With low prices and a history of declining volume due to poor weather, these respondents most often worry about increasing costs.

With marketing and supply functions, various tensions between the environment of the cooperative and the cooperative organization become evident. With marketing cooperatives, respondents identified operational difficulties within a larger context of the agricultural economy, competition and low commodity prices. With farm supply cooperatives, respondents identified low margins within a larger context of the agricultural economy and low commodity prices. With service cooperatives, respondents identified low prices and weather as well as increasing costs as problem areas. “Increasing costs” are particularly worrisome.

When respondents shifted focus to the near future, larger structural comments became more prevalent.

### Influence of co-op size

Low margins, increasing costs, low commodity prices and size of cooperative are all closely inter-related. If a cooperative is

struggling with low margins, they can sometimes be improved by increasing prices and/or lowering costs. In a market of pervasively low prices and thin margins, a rise in costs can be particularly problematic. Not only can the cooperative not raise prices, but in a climate of “increasing costs,” the cooperative is not likely to be able to reduce its own costs and improve margins.

These difficulties may be particularly ominous with smaller cooperatives, because they also have smaller volumes. In an environment of increasing costs, smaller cooperatives may have more difficulty maintaining margins than larger cooperatives, given that larger cooperatives can spread costs over greater volumes. Smaller cooperatives with smaller volumes have less room to spread costs.

This is particularly difficult in an environment of increasing costs. Smaller cooperatives will likely find it more difficult to maintain or improve the survivability of the organization. Competitive problems only deepen these dynamics, compounding the difficulty of maintaining margins in an environment of low prices and increasing costs.

These relationships tended to be borne out when considering problems based on co-op size. Operational difficulties addressed the internal problems with which cooperatives struggled to improve margins in an environment of low prices and increasing costs. For smaller cooperatives that find it difficult to spread increased costs over larger volumes, competition emerges as a more frequently cited challenge, making it more difficult to expand volumes. For larger cooperatives with much larger volumes, labor issues were identified as more problematic for the near future, though labor was cited by some smaller cooperatives as well.

The agricultural economy was among the most often cited problem areas across all sizes. As with other considerations, when respondents shifted focus to the future, structural considerations were cited more often. Regardless of the shifts in costs, margins, size, growth and/or consolidations, the loss of the farming base represents fewer farmers and increased competition for a greater number of larger-volume farms.

### Big concern: survivability

The responses showed a deep concern with the survival of farmer-members and cooperatives. Survival of farmers was seen as a product of the various influences that went into producer profitability. Low commodity prices were understood as pervasive, both in the past and as expected in the future. These low prices were partly due to excess supply, driven by expansion in the production of various commodities in some domestic regions, as well as increased imports of low-cost foreign goods.

Producers had to face these low commodity prices along with the rising costs of fertilizers, energy and, in some instances, labor. The problems of low prices and increased costs were compounded in some regions by weather conditions that reduced local volumes. Under such conditions—low prices, increasing costs, and declining volumes—producer profitability drops and survivability becomes more difficult.

Some farmers discontinue operations due to inadequate

**Table 1—Problems identified by co-op management**

Problem or issue	For past year <sup>1</sup>		For near future	
	Number	Percent	Number	Percent
Low commodity prices	281	18.8	242	15.5
Agricultural economy	199	13.3	278	17.8
Operational	165	11.0	159	10.2
Increasing costs	135	9.0	155	9.9
Labor	124	8.3	113	7.2
Low margins	118	7.9	113	7.2
Competition	116	7.8	136	8.7
Weather	98	6.6	61	3.9
Accounts receivable	48	3.2	35	2.2
Government regulations	47	3.1	55	3.5
Other	35	2.3	34	2.2
Government programs	30	2.0	36	2.3
Members	28	1.9	32	2.0
Genetically modified crops	20	1.3	22	1.4
Technology	19	1.3	54	3.5
Transportation	17	1.1	15	1.0
Consolidation	16	1.1	25	1.6
Total <sup>2</sup>	1,496	100.0	1,565	100.0

<sup>1</sup> A number of cooperatives reported more than one problem. The second and third problems listed were included in the total responses. The cooperatives were not asked to give any priority or ranking to the problems reported.

<sup>2</sup> Totals may not add due to rounding.

earnings. Others discontinue operations due to retirement, urbanization and health problems. Some farmers develop strategies to stay in business. They may seek greater volumes by expanding both vertically and horizontally. Some engage in contract production or use other practices (Internet purchases and sales) to improve the overall efficiency of their farm operations.

Many of these dynamics have direct impact on cooperative survivability. Fewer farmers can reduce local volume, commodities sold and supplies and services purchased. Large farms with greater volumes may have the option to bypass local cooperatives and go direct to terminals.

Others that do not bypass the local may want better deals from their cooperatives. Those who contract with investor-owned firms channel volume away from cooperatives.

Cooperatives must operate in an environment of increasing costs. Reduced volumes, low prices and increased costs have contributed to low margins. Coop-

eratives have sought to respond with various operational adjustments—niche marketing, improving financing, managing debt, improving efficiency and expanding growth—as well as improving returns to farmer-members, thereby helping keep them in business (and preserving volumes).

Some cooperatives have gone out of business. Others have sought to make various organizational changes, including closing smaller branches, increasing the number of locations and forming mergers, joint ventures and strategic alliances. These organizational changes have been undertaken in an environment where other competitive agri-food organizations are consolidating and integrating—both vertically and horizontally—creating food chains with multi-regional and global reach.

#### About the survey...

Information was collected by adding two open-ended questions to RBS' annual survey of farmer cooperatives.

1. "In the past year (ending in 2000,) what did your management consider to be the major problem or issue facing your cooperative?"
2. "What does your management see as the major problem or issue facing your cooperative in the next year or two?"

Responses were received from 1,147 of the 3,058 cooperatives surveyed. Most of the responses were short, such as "accounts receivable," "decline in farmers," "competition" and "low farm prices." Some cooperatives identified more than one problem or issue, such as "low farm income and excessive government regulations" or "imports, retail consolidation, prices."

Seventeen problem areas or classifications were identified. For example, included under "the agricultural economy" were such responses as: "changes in agriculture structure," "depressed farm economy," "declining number of farmers," "decrease in production," "losing small family farms," "encroachment from development" and "declining net income of farmers."

Other problem areas cited were accounts receivable, competition, consolidation, technology, genetically modified crops, government regulation, government programs, increasing costs, labor, low commodity prices, operational problems, transportation, weather, members and low margins.

The classification system was used for responses received for both the past year and the near future. A two-tier methodology was used to report the findings. In the first tier, those problems that accounted for at least 50 percent of the responses were reported. In the second tier, identified problems were reported that accounted for at least an additional 5 percent of the total responses in a specific category. In some cases where response numbers were few, problems were noted if at least 10 responses were received.

Problems were analyzed by cooperative function, type, size and region of the country for both the past year and the near future. From these analyses, various relationships among the problem areas were revealed. ■

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# South Dakota turnaround

*Farmers who once couldn't give away their co-op find success through service and slow, steady growth*

**Dan Campbell, editor**



ow low can you go? How about offering to sell your cooperative—lock stock and barrel—to a neighboring co-op for one lousy dollar, but then getting turned down!

That was the situation in the early 1960s facing Valley Springs Farmers Cooperative, a local farm supply/grain co-op near the Minnesota-South Dakota state line east of Sioux Falls, S.D. However, that rejection proved to be a blessing in disguise. The co-op “went back, re-focused” and pulled itself up by the bootstraps, says board President David Kolsrud. “They weren’t about to throw in the towel—they were willing to do whatever it took to make it work. The members stayed loyal to the co-op and turned it around.”

Today it is a highly successful operation with a growing membership and strong balance sheet. Indeed, an analyst for a major chemical supplier that deals with hundreds of Midwest co-ops recently told Valley Springs it has the strongest balance sheet of any local co-op the company works with. The co-op’s 2002 annual report shows patrons’ equity of \$1.9 million and total assets of \$2.5 million, a .75 ratio of equity-to-assets. It owes only \$79,000 in long-term debt (for a lease).

“That is about as strong (a balance sheet) as you’ll see,” confirms Randall Torgerson, deputy administrator for USDA Rural Business-Cooperative Service.

Valley Springs had just under \$4.3 million in total sales for 2002, up from \$3.9 million in 2001. Net pre-tax proceeds in 2002 were \$186,000, up from \$165,000 in 2001. The co-op sold more than 653,700 bushels of grain (mostly corn and soybeans) in 2002, up from 633,000 bushels in 2001. Other major sale centers for Valley Springs are fertilizer, petroleum, agronomy services and feed.

## Reversal of fortune

The picture was not so rosy when a young man named Paul Edmundson, a farm boy from nearby Rock County, Minn., arrived at Valley springs in the early 1970s. He started as a laborer but quickly worked his way up to co-op manager, a job he’s held since 1974.

The key to the co-op’s reversal of fortune, Edmundson says,



*“We’ve been putting our money in agronomy, because that’s where the profits are,” says Valley Springs Manager Paul Edmundson, seen here on a dry fertilizer, air-flow applicator rig. Photos for USDA by Greg Latza*

was a combination of providing individual service to members, a policy of slow, steady growth (rather than growth through merger), and a conservative business approach that involved carrying a minimal debt load. “With maybe a little good luck thrown in,” Edmundson adds.

Some recent co-op failures have been attributed to overly aggressive merger philosophies, in which the buyer took on too many liabilities of the co-ops it acquired. Valley Springs has instead preferred to expand its member base without merging. “Our philosophy has always been, if you take care

of members, new members will come in through the door. And that's what has happened," says Kolsrud.

"We owed \$54,000 back when I took over—which I thought seemed like an unreal amount of money to owe back then," Edmundson continues. "Today, of course, people would look at that as a drop in the bucket. But the first thing I did was pay off the debt. My goal was then to get to \$1 million in working capital; we've passed that mark now. We may borrow a little during peak season, but usually only for a month or so."

Kolsrud says Edmundson's skills as a manager have played a big part in the co-op's climb back up the hill. "Paul is a master at managing inventory and money," says Kolsrud, who knows something about management, since he wears that hat for the nearby Corn-er Stone Farmers Co-op in Luverne, Minn. "And he knows how to delegate authority. He hires an agronomist, then lets him make the agronomy decisions without second-guessing him."

Yes, employees do make mistakes. "But I don't climb down their throat," Edmundson says. "If they don't ever make mistakes, they probably aren't trying hard enough."

#### **Grain philosophy: move it or lose it**

The co-op is known for its ability to move corn and soybeans rapidly. It can store about 300,000 bushels in its elevator and three grain bins in the small town of Valley Springs, S.D., population about 900.

"We often buy grain in the morning, sell it and truck it out the same afternoon," says Kolsrud. "We would rather make a nickle (a bushel) than to gamble by piling it on the ground."

With a harvest that can last until Thanksgiving, there is always a real danger of snow or rain damaging crops stored outside, hence the co-op's desire to move it or lose it. "We put wheels under it as fast as we can," confirms Edmundson.

The cooperative, which faced another crisis in 1979 when its major facilities burned down, today needs increased storage, Edmundson says. "We rebuilt quickly after the fire, and we were probably too conservative. We went smaller than we should have, or would have, had we known how steady our growth would be." The co-op will likely be adding another 50,000 to 75,000 bushels to its storage capacity in the future.

There is no rail service to the elevator, so the truck scales are a busy place come harvest season. At the peak, it's not unusual for 40 to 50 semi-trucks to roll through the co-op elevator in a day, moving 42,000 bushels in and out.

The biggest shift in the business in recent years has been in the amount of corn going to ethanol. The ethanol market,



*Board President David Kolsrud, left, says the use of quarterly financial reports has been an invaluable tool in keeping Valley Springs headed upward. With him are co-op member John Sjaarda and Manager Paul Edmundson.*

which now gets about 90 percent of the co-op's corn, has helped offset the drop in sales to the livestock industry, which has been in decline in the area. But now, with ethanol providing feed as a byproduct, there's been a resurgence in livestock feeding near the ethanol plants, Edmundson says. Most of the co-op's corn is sold to Corn-er Stone (see sidebar), of which Valley Springs is a member.

"Ethanol is definitely the new thing around here," says Valley Springs member Dave Willers, who farms about 2,000 acres with his brother near Beaver Creek, Minn. But having seen the ethanol market rise and fall in the past, he is still somewhat cautious, even though this time he thinks the industry has real legs under it. "I hope we're not hanging our hat too much on ethanol. But I think ethanol is going to be an important piece of the pie for us in the future."

#### **Agronomy service growing**

As livestock numbers dropped in the area, the parallel trend has been for the co-op to devote more of its resources to agronomy services. Despite its conservative business philosophy, Valley Springs does not skimp when it comes to equipment. Its inventory includes state-of-the-art machinery, including applicators with global positioning gear for precise, cost-efficient coverage.

"We've been putting our money into agronomy, because that's where the profits are," says Edmundson. In the past year alone, the cooperative has purchased an air-flow dry fertilizer spreader, a field sprayer, a fork lift, a skid loader and two pickup trucks—all new. In the office, things are a little less high-tech, as evidenced by the rotary-dial telephones.

During the spring, when the fertilizer rigs are flying, Edmundson and the other employees often work from

about 4 a.m. until 9:30 at night. The co-op has five full-time employees, who are supplemented with five seasonal workers during peak business periods.

Inventory control is done the "old-fashioned, hands-on way," says Edmundson. "I don't use a computer much." The rule for scheduling agronomy service to members is to do whatever it takes to meet a commitment to a member.

### Commandment No. 1: know thy members

By remaining small—the co-op has about 400 members, of which perhaps 150 are very active—the co-op has maintained a close working relationship with members.

"It still has a farmer identity—they know us and we know them," says Willers.

"If there's one thing I can't stress enough, it's that our co-op has succeeded

by anticipating and meeting the needs of our members," says Kolsrud. "And we never overlooked the smaller, loyal members in order to go down the road and sign up a mega-farm."

As a result, the co-op membership today represents a good cross section of the farm community it serves. "Our members range from weekend farmers to producers with 3,000 acres or more," says Edmundson. In addition to corn/soybean farmers, the membership

## USDA-backed ethanol plant paying off for members

The success of a \$20 million corn-to-ethanol plant built in Luverne, Minn., has proven to be a major asset for farmers in the southeast South Dakota area. Completed in 1998 with the help of a \$5 million Business and Industry loan guarantee from USDA's Rural Business-Cooperative Service, the Agri-Energy LLC plant is paying farmers a substantial return on their investment, says David Kolsrud, manager of Corn-er Stone Farmers Co-op, one of three owners in the LLC (along with Corn Energy Investors and Fagen Inc.).

The co-op had net income of \$5.2 million in 2001, up from \$2.2 million in 2000. Total operating expenses last year were only \$98,000.

The success of the ethanol operation has not gone unnoticed. The co-op has received a purchase offer for several times the construction cost, Kolsrud says. But so far the current owners have no intention of selling.

Kolsrud says he thinks that too many farmers are making a mistake when they let outsiders put up the bulk of the money for ethanol or soybean processing plants.

"I think there is a growing fallacy out there that it was fine for farmers to be in the drivers' seat for a time on these new generation co-ops. But—as the projects get bigger—people come into town and say: 'Well, there's no money in farming; let's get some outside capital and then find a few farmers to work with to get this plant built.'

"I totally disagree with that view. There's plenty of equity to be had in most farming communities for the right project with good leadership. On any given day, most of the nation's 300,000 significant producers can each leverage \$100,000 just on their land and machinery," Kolsrud says. "If you take just 100,000 of those producers, that's \$10 bil-

lion. Enough to buy out the biggest agri-business giants."

"Leadership is the key to getting farmers to invest in value-added projects—they have to see someone they know and respect leading the way," adds David Willers, a local cooperative member. Seed money provided by USDA Rural Development through its new value-added grant program can be the key catalyst to reviving the economy in many rural areas, Kolsrud and Willers say.

"Seed money is critical in the early stage, when you are developing the business plan that will be used to attract farmers to invest," Willers continues. "You need to be able to hire expert help to develop a solid business plan that will clearly explain the project. USDA's value-added grant program is exactly what rural America needs."

Getting off on the right foot is critical, Kolsrud emphasizes. "Profits that flow back to the farmers will be determined when you write your bylaws and articles of incorporation. If you don't have the right

legal and accounting work done at the beginning, your project will never be what it could have been. That's why value-added grant programs are so good—they help you lay the foundation properly."

"If you get past that step and still have people believing in you, you can usually go out and raise the money you need," Willers says.

### Co-op vs. LLC structure

Some new ethanol ventures are organizing as limited liability corporations (LLCs), rather than as co-ops. Still other cooperatives have converted to LLCs and more are considering it. "I'm a co-op man, so this trend concerns me," Kolsrud says.

An ethanol plant owned by an LLC has two major



*David Kolsrud – outside the Corn-er Stone ethanol plant – says he thinks producers should do all they can to raise their own equity without relying too heavily on outside investors.*

also includes cow-calf operators and some dairy farmers.

The board and overall membership of Valley Springs tend to be younger than average for a Midwest farmers' co-op, which Willers says bodes well for the future. "We've been fortunate to have very intelligent, committed board members," he notes. And they don't do it for the pay. Kolsrud, who has just pocketed his annual paycheck for serving on

the board, says: "\$100 for all those meetings. But that's OK—that's what makes a co-op a co-op!"

#### **Quarterly reports "invaluable"**

The co-op leaders also subscribe to the business philosophy that if you can measure it, you can manage it. A key management tool which Kolsrud and Edmundson say has helped keep the co-op "operating on an even keel" is the use of quarterly financial statements,

which are reviewed very carefully by management and directors.

"The quarterly report has been a great yardstick. It enables us to compare our business to each of the past two years," says Kolsrud. "Every three months, we use it to sit down and get a very close look at the financial condition of all aspects of the co-op's operations. You can look at everything from your insurance costs to sales trends.

advantages over co-op-ownership, Kolsrud continues. First, co-ops cannot take advantage of the small ethanol producers' tax credit. He estimates that costs Corn-er Stone members 10 to 30 cents per bushel.

"Every other type of business can take that credit—LLCs, partnerships, private ownership—but not co-ops," Kolsrud says, blaming the situation on "a quirk of the law" which he thinks arose from its framers not having an accurate understanding of the tax status of co-ops.

The second disadvantage for co-ops is that they must report income they derive from an ethanol plant on their Schedule F tax form, which is then subject to Social Security taxes. LLCs do not have to.

On the other hand, Kolsrud notes that co-ops are still easier to organize, they have fewer Securities and Exchange Commission laws to contend with, and they enjoy limited exemption from anti-trust laws under the Capper-Volstead Act. Indeed, co-ops don't have to register with the SEC, which attorney J. Gary McDavid—speaking at the New Generation Cooperative Leaders Conference in Washington in March—called "a huge advantage for co-ops." Other co-op advantages mentioned during that discussion were that co-ops are eligible for more USDA financial programs than are LLCs, and that an LLC has to file a state tax return for every state in which it does business (if business exceeds a certain level), which was called "a major hassle."

It is the tax advantages enjoyed by LLCs for ethanol projects that seem to be swaying many people, Kolsrud says. A business incorporated as an LLC but having bylaws structured so that it operates on a cooperative basis—with true cooperative principles and which remains under producer control—might be an acceptable business form, Kolsrud says. "But the way some are being set up, it's too easy for outside investors to gain control. The odds are great that many of these LLCs will not—in the long run—be run for the producers' benefit."

*"There's plenty of equity to be had in most farming communities for the right project with good leadership."*

#### **Seeking energy bill changes**

The National Council of Farmer Cooperatives (NCFC), National Cooperative Business Association and others are working to get changes made in the Senate Energy Bill that will help cooperatives on several fronts.

"Farmer Cooperatives provide 40 percent of the nation's on-farm fuel supply and are the critical link in the fuel supply chain for much of rural America," says Randy Jones, NCFC senior vice president. The seasonal nature of agriculture makes getting the right supply to the right place at the right time extremely important, he adds,

"which is why farmers—through their cooperatives—have invested heavily in petroleum refining and distribution."

NCFC has been supporting language in the Senate bill that provides incentives for renewable fuels—mainly ethanol and biodiesel. This includes provisions that would

expand the definition of a "small ethanol producer" from 30 million to 60 million gallons and allow farmer cooperatives to pass on to its farmer owners the current 10-cent-per-gallon small producer ethanol tax credit.

A major issue facing farmer cooperative refiners involves EPA-mandated low sulfur diesel regulations. According to NCFC, such regulations could cost the nation's four farmer-owned cooperative refineries \$400 million to \$500 million in retro-fitting expenses. In an effort to help offset such costs and the impact on farmers, NCFC is supporting language that would allow farmer cooperatives (along with other small refiners) to write off up to 75 percent of the capital cost of complying with those regulations.

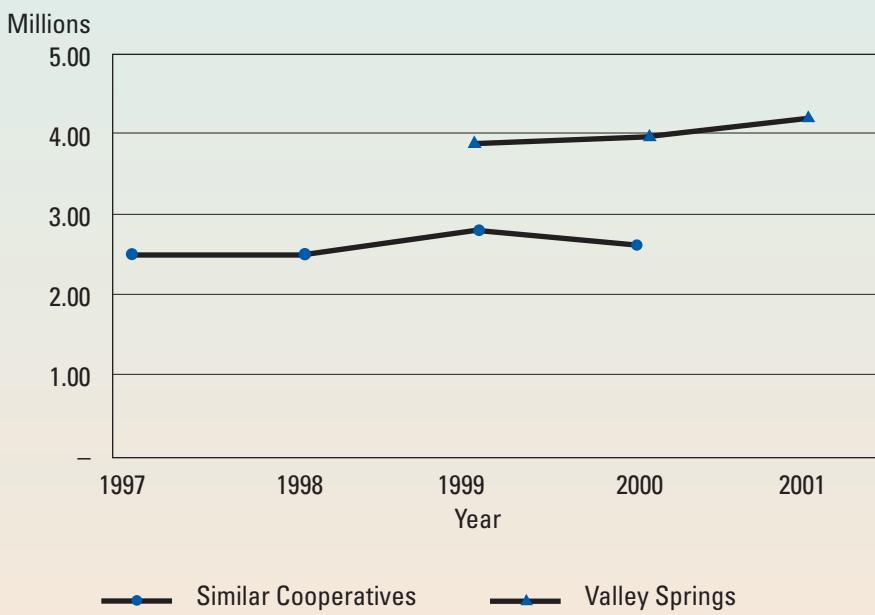
It would also provide a 5-cent-per-gallon environmental tax credit for farmer cooperatives and other small refineries that produce low-sulfur diesel. Co-ops would be allowed to pass that break along to their farmer members. ■

—By Dan Campbell, editor

"Many managers do not like quarterly audits, but we've done it for years and Paul and the board like the system," Kolsrud continues. "The really amazing thing is how consistent things have been from year to year."

While the board keeps close tabs on operations with the reports, it strives hard not to micro-manage the operation. "We leave the day-to-day operations up to Paul, as it should be," Kolsrud says.

**Figure 1—Total sales**



**Figure 2—Local savings**

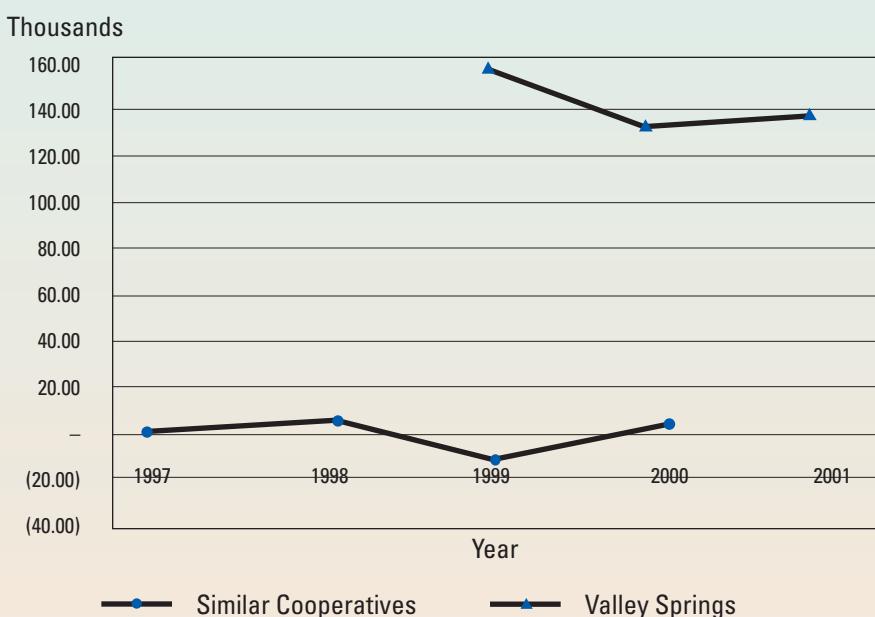
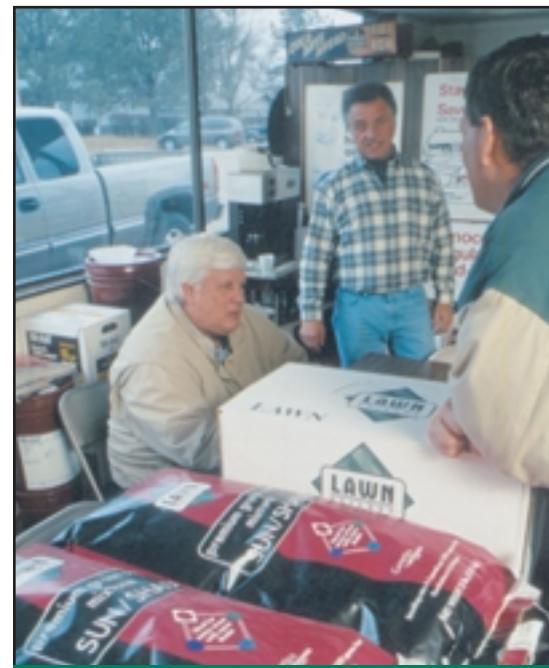


Figure 1 illustrates the Valley Springs Farmers Cooperative's strong and growing sales levels for grain and farm supplies (compared to similar size and type co-ops). Figure 2 shows its much higher than average income level.



*While they don't rule out a merger in the future, none are planned, and Kolsrud, left and Edmundson say they are pleased with the co-op's current growth.*

#### Annual meeting guest poses critical questions

When Valley Springs held its annual meeting last year, the guest speaker was well known to many of the members. They remembered CHS Chief Executive Officer John Johnson from his days in the mid-1970s as their GTA (now CHS) feed salesman.

"And he still remembers most of us," Willers recalls.

"John credited Valley Springs for being a traditional co-op that has succeeded by being member-focused, and for going against the tide of mergers," Kolsrud said. "But he questioned how long we would be able to do that in a global marketplace."

The question of growth is a major topic facing the co-op. "We're not ruling out a merger," says Kolsrud. "But we're getting new members all the time, and our volume keeps going up."

"Mergers have certainly diluted loyalty in a lot of co-ops," adds Willers.

"I'm not saying it won't happen," adds Kolsrud. "But right now, we like the way things are going." ■

# Getting the green light

*CoBank business development officer discusses essential planning needed to finance an added-value cooperative*

**By Jeff Kistner  
with Catherine Merlo**

**Editor's Note:** Kistner is a business development officer with CoBank in Denver, Colo. This article is based on a presentation he made at USDA's most recent Agricultural Outlook Forum. He can be reached at (800) 346-5717, extension 2025 or at [jkistner@cobank.com](mailto:jkistner@cobank.com). If you have questions regarding feasibility studies or business plans, contact Kirk Martin at (303) 740-4060. Merlo is a writer and public affairs specialist based in Bakersfield, Calif., who is a frequent contributor to this publication.

Is your agricultural organization considering a start-up venture that can add value to the company's business operations?

You're not alone if you are. Over the past 10 years, hundreds of agricultural businesses across the United States have ventured into added-value operations, from food-producing enterprises to operations that produce renewable fuels derived from soybeans and corn. Some have been successful, some have not.

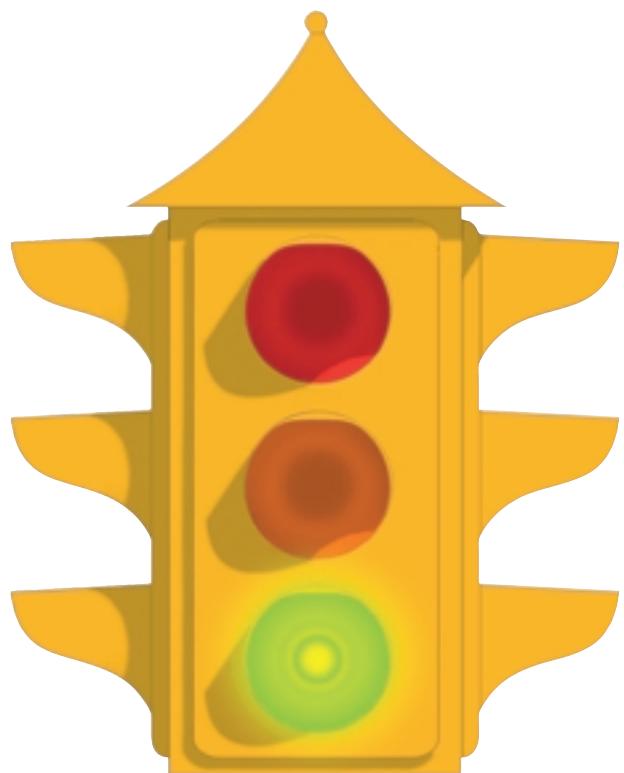
As a major provider of financial solutions to rural America, CoBank has looked at many added-value ventures in the last decade. We've been involved in financing ethanol and diesel, pasta, corn-milling, turkey- and beef-processing plants. We know what steps must be taken to ensure that these added-value ventures succeed. Using ethanol as an example, here is a road map to launching an added-value venture.

## The first steps

The first step in determining whether the project has merit involves the added-value equation, or balancing the elements of the proposed venture. To calculate the equation, a lender lines up the project's strengths, weaknesses and uncertainties in a column format. In order for the project to proceed, its strengths minus its weaknesses must be greater than its uncertainties. If that equation holds true, the project can proceed to the next step—attracting financing.

Lenders look at five credit factors:

- Capacity—the repayment capability.
- Capital—the financial condition or the balance sheet of the business.
- Character—the management.
- Collateral—the quality and value of the secondary repayment source. The collateral in most added-value propositions may only be used for the designated purpose and, therefore, is considered a special-use asset.
- Conditions—the purpose, amount and requirements to operate the business. Lenders look at this credit factor from two perspectives: the external and the internal. External conditions cover such areas as the economy, whether there is enough production in the area to support the venture, demand for the output,



and government regulations. Internal conditions include the loan covenants and the business's ability to meet a minimum set of financial standards.

Once these credit factors are known, you can move to the start-up stage for your added-value project. You must follow each stage in order. If you jump ahead, you'll have problems and you'll end up backtracking.

You should start with an initial meeting, which is the official formation of the venture. Several questions must be answered at this meeting:

- Is there a group of producers willing to invest in, or to be part of, this business?
- If so, have you formed your organization? Will it be structured as a not-for-profit organization, a co-op, a C or S corporation, a limited liability corporation (LLC), or maybe the new Wyoming Co-op?
- Have you secured seed money? This means more than just applying for a state or federal grant or

finding an economic development person to do some work for you. It means the owners must make an initial cash investment that the venture can apply towards research and development.

### **Moving on to a feasibility study and a business plan**

Once the seed money is secure, you must conduct a feasibility study. This outlines the global picture, which doesn't necessarily refer to an international scenario. It may be local, regional or national, depending on your targeted market and the proximity of your competition. The feasibility study addresses such issues as how your organization will fit into the global picture and what you must do to be competitive. There are five components of a feasibility study:

- Technology
- Management
- Markets
- Economic conditions
- Your financial projections

These five components are basically what USDA requires for an analysis for its Business and Industry Loan Guarantee Program.

The feasibility study addresses supply and demand characteristics. It discusses the importance of a steady supply of raw materials and reviews market share, pricing trends and sensitivities. It outlines your cost competitiveness and determines if you will be a high-cost or a low-cost producer. It answers such questions as: Can you get into the market? Can you enter into contracts? Are your financial projections realistic? It also outlines scenarios for worst-case, best-case and what-if situations. Finally, it details your capitalization structure.

The feasibility study is one of the most important steps you can take on your way to becoming a successful added-value venture. Yet, some organizations that are willing to spend \$15 million on a new plant skip this step because they are reluctant to spend the \$20,000 to \$40,000 required for a feasibility study. Still others rely on people who will gain from their involvement in the added-value venture to conduct

their feasibility studies. Instead, use unbiased, third party assistance; an impartial feasibility study should be your goal.

Once the feasibility study is done and you've outlined the global picture, you will know against whom you're competing. For example, if you're building a plant in Missouri, you may be competing with southern Minnesota, western Iowa or South Dakota. How will your operation fit into that region?

To answer that question, you must move to the next step—the business plan.

### **On to the business plan**

The business plan offers a different point of view from the global perspective of the feasibility study. It extrapolates the information to the local level. The business plan provides details about the operation, the market, management and the organization's financials. It also addresses how to create a profitable income stream for investors.

The business plan covers:

- Markets. This will tell you who you'll be selling to, how much of the market share you want, and the quantity of product you can expect to sell. That "who" is a critical element. It covers your customers and competitors.
- Management. This details the players, and consists of profiles on the board members as well as the general manager, who will run the daily operations.
- Money. This covers capital and cash flow.

Included in the business plan is the marketing element. That marketing plan should outline how you'll create wealth for the investors and owners. It should provide details on your customer base and on the competition. It should include specific tactics for executing the marketing strategy. It should also consider whether there is a distribution channel in place. You need to know if there are existing railroads you can use to move the ethanol or if you will need to transport it by truck or barge.

A business plan also answers such questions as: Are there alliances or marketing firms you can partner with? Are there marketing contracts you can enter into? A business plan also should provide for market contingencies or backups. Backup plans should cover not only markets but also the operations. One contingency that should always be covered is when to end your investment. For example, if you've been losing money for three years, you need to know if it's time to pull the plug.

### **Delving into the operating plan**

One management element of the business plan is the operating plan. For this, you'll need to look at who's going to build the facilities and select the engineers and technology experts. Today's ethanol industry is a mature one, which means there are proven engineers and builders who have successfully built and run ethanol plants.

Selecting management is an impor-

## **Start-up stages for added-value ventures**

- Hold initial meeting
- Form organization
- Secure seed money
- Conduct feasibility study:
  - Economic
  - Market
  - Technical
  - Financial
  - Management
- Develop business plan:
  - Operation plan
  - Marketing plan
  - Management plan
  - Financial plan
- Develop prospectus
- Hold membership drive
- Hold annual meeting
- Finance project
- Hire manager
- Construct project
- Begin operation ■

tant component of the operating plan. Management is a key to the feasibility of an ethanol or biomass venture. Therefore, you need to know which individuals have the expertise you need. This is a particularly big issue in ethanol when you consider all the ethanol plants being discussed in the Corn Belt.

Before you begin your management selection, you must answer some basic questions. Are you going to do a broad-based search for a manager? At what stage will you employ a manager? Hiring the management during the early stages of start-up could be beneficial to help implement the plans and membership drives—if you have the right seed money to support him or her. You must first determine the compensation package. And that package must compare favorably with what your competition is offering. You also need to decide if you're willing to reward your management based upon long-term results.

### **Focusing on financials**

After you've selected your manager, start looking at the financial or money elements. The financials in the business plan basically focus on three key items: return on investment, equity strategy and debt strategy. We also add a fourth element: guarantees. In most added-value ventures, looking at a USDA Business and Industry Loan guarantee is an important element for future success as it minimizes some of the future risk in case something should happen with your business.

What is the risk of return, and what's the right return on investment? The right return is specific to your organization and depends on your venture's goals. A common expected rate of return is 15 percent. That figure is derived by assuming the investor will take money out of his existing business, or farmer operation, to invest in an added-value project, such as ethanol. If he invests that money in the stock market, he can expect an average 10 percent return. On the other hand, if that investor wanted to get into ethanol, he could also invest the

## **What a co-op needs to be a player in capital markets:**

- Strategic vision and a sound business plan—Where you're going, how you're going to get there and how it compares with past performance.
- Financial size.
- Consistent financial performance. This provides any organization with flexibility and alternatives. It positions an organization as an attractive business partner. All of which are key to increasing your financial capacity.
- Appropriate management skill set.
- Capable board and management that understand governance implications, exit strategies of debt/equity tools.
- Established regional or national brands help. ■

money in an investor-owned energy stock. Therefore, if he's going to invest in your business, his return should be greater than the stock market's average 10 percent return.

On the other hand, if you would like to bring in venture capital for your added-value project, those investors will look for a 20 to 25 percent return. Yes, venture capital is coming back to agriculture as a result of the beating it's taken in the technology sector in recent years.

Or, your venture may just need to have a return high enough to cover the additional expense that you're going to incur to stay operational.

### **Risk and return**

When you're determining the right rate of return on investment for your operation, you must make sure you don't include the return from the sale of your raw material. If you're going to deliver corn to the ethanol plant, that corn has a market price. An increase in the market price will have a negative effect on your business. It's fine to take your stock appreciation and your dividend and add that back to just the corn bushels delivered—there's your premium. But if you build your premium upfront, the chance of your business showing a profit or paying a dividend is unlikely.

There have been many instances in which an ethanol plant has increased

the basis of corn in an area by 10 cents or more. Obviously, this is beneficial to the farmers who did not invest in the added-value project, because they're receiving a higher corn price with no additional investment. However, while the producer members of the co-op are also getting a higher price for their corn, their return on investment from the ethanol plant is lower than expected. Therefore, you don't want to raise the market for the price of your commodity. What you want to do is increase the return on your investment.

Finally, if you're considering this added-value venture because it provides the ability to stay on the farm, you'll need to look at the project differently. Basically, you're going to break even or even lose some money.

### **How much capital?**

Moving forward in the money segment of your business plan, there are other items to consider when financing or planning a value-added project. Lenders look at financing the entire business and not just different components of the business. The entire business has three primary components to consider: the total cost of plant, property and equipment; start-up expenses from the planning stage through full capacity; and beginning working capital.

Groups often wonder how much capital they need to raise. Unless your

*continued on page 34*

# Ask the right questions

*Members should probe reasons for co-op conversions, other major changes*

**By James Baarda, Agricultural Economist**

**Randall Torgerson, Deputy Administrator**  
*USDA Rural Business-Cooperative Service*



ember involvement is a hallmark of cooperatives. Members create, finance and patronize the cooperative. They decide major changes in the cooperative, such as a merger or its dissolution. But the most common means by which members control the business occurs when they elect directors, who are usually members themselves.

Recent events in the formation of cooperatives with non-traditional characteristics—and the subsequent change or failure of those organizations—have reminded us all that another one of a member's most fundamental duties in a cooperative is to ask the right questions.

Two situations require members to pay particularly close attention. Members have a vested interest in the arrangement when a cooperative considers an association with another organization or business that may have significant impacts on the character of the cooperative. This may occur when the cooperative is being formed, or may occur later. An example is when a cooperative hires advisors and promoters to finance and establish a turn-key plant.

Members also have a direct interest in cooperative decisions when the board is considering actions to convert the cooperative to another kind of business or organizational structure.

This situation may occur when a cooperative proposes to convert to a non-cooperative corporation or one or more limited liability companies (LLCs). In both instances, member inquiries and requests for information are legitimate, necessary and healthy for the cooperative—if done in the right way for the right reasons.

We have seen instances recently in which new-generation cooperatives (NGC) decide to convert to a non-cooperative corporation. NGC members should ask a series of questions about why the cooperative failed to meet its objectives as a cooperative and why the conversion is a solution to the problem. Members will want to know exactly what led to conversion considerations. Was the cooperative consistently operating at a loss? Was the cooperative unable to make further investments because of a lack of capital sources from its members? Is additional capital required to increase the members' benefit as producers of product used by the cooperative?

## Members and good analysis

Members need to look carefully at the source of the problem. It is critical that members determine if the form of the cooperative organization itself had an inherent weakness. Or was poor performance or limited potential the result of inadequate business planning or poor management?

Members should look objectively at themselves, too. Did member behavior undermine the cooperative? Refusal to deliver, or promises to deliver that couldn't be met, may have made efficient cooperative operation impossible.

Members may have shown signs of their own unrealistic expectations and lack of commitment to cooperation.

Members may also have established in the new business a philosophy not compatible with a cooperative. If members expected to make money on their investment in the organization rather than through product delivery and patronage returns, the stage is set for cooperative failure. Perhaps market projections were overly optimistic, or maybe the market is simply not there any more, in which case no profitable enterprise could flourish. In any case, members should understand the issues. Objective assessment begins with the right questions.

Once members understand what happened and why, they can look forward. The critical question for the future: What can be done to preserve the cooperative? Just contemplating conversion to a non-cooperative corporation or LLC shows that someone believes that a cooperative cannot survive and provide the services and income expected of the cooperative. This is a very serious position to take and members should question that conclusion vigorously. The cooperative may have been poorly conceived and corrections in structure or operations may be the solution, not abandonment of the cooperative.

Was the organization created with true cooperative principles? Were cooperative principles ignored or stretched to the breaking point? Was the organization formed for the sole benefit of farmer-users and was the benefit to accrue to farmers on a cooperative basis? Members will need to



*Because they direct profits back to members as patronage, rather than to investors living in distant locations, cooperatives help add to the economic vitality of rural communities.* USDA Photo by Ken Hammond

assess who will benefit from conversion to a non-cooperative business and what is driving the conversion idea. In a retrospective analysis, members may find that the problem was simple, but also fundamental. Then the task is to correct the problem.

The final set of questions that members should ask is to explore the impact of conversion from a cooperative to non-cooperative organization. From a purely business perspective, if the cooperative wouldn't work, why would a non-cooperative corporation or an LLC fare any better? Members will have a difficult time finding built-in deficiencies in a cooperative that can be overcome by converting to a non-cooperative corporation or LLC. If such disadvantages do exist, comparisons between a cooperative and a non-cooperative corporation or LLC may show that conversion is still not justified. Detriments to farmers and the community from loss of the cooperative may still far outweigh any advantages perceived for conversion.

Members should also consider that if the cooperative disappears, they may only then appreciate its true value. But at that point, creation of a new cooperative will force them to endure added costs and face other obstacles. They

should be cautious of management that constantly presses the cooperative to engage in outside business unrelated to the core member business. Growth for the sake of growth, rather than to increase the cooperative's ability to serve farmers, is also a cautionary signpost. A subtle, but unwarranted, change in the cooperative's character may occur in a progressive manner.

#### **Cooperative principles count**

Cooperative members and their boards of directors have the mechanism to preserve the cooperative. The best—in fact, the only—questions to guide members in conversion issues are those that get to the core co-op principles that guarantee that benefits of the enterprise belong to the farmers and that control rests in farmers' hands. When members abandon a cooperative for a non-cooperative organization, what do they lose?

Members measure losses by reference to cooperative principles. The user-owner principle states that those who own and finance the cooperative are those who use it. A non-cooperative corporation can, of course, be owned by farmers, but conversion to a non-cooperative will most certainly require former members to share the

ownership, control and benefits with non-members. Indeed, the arguments for conversion may be primarily based on accessibility to outside capital. That capital has a cost to members, and they need to appreciate what that cost is.

The user-control principle states that those who control the cooperative are those who use it. Farmer-member control is lost, or is at least fundamentally changed, when a co-op converts to another form of business. Investors—not the users—control a non-cooperative business, and typically the more the investment the greater the power of control. Farmers may, of course, maintain their investment in the new organization. But farmers will be nothing more than shareholders in a business the control of which is (technically) shared by many, but—in reality—often winds up in the hands of a few.

The user-benefits principle establishes that the cooperative's sole purpose is to provide and distribute benefits to its users on the basis of their use. That ends with conversion. Members are well advised to seriously consider the implications of such a change. The original purpose of the cooperative was to garner income by participation in downstream processing and marketing.

The implications of conversion for

members are actually two-fold. After conversion, benefits—in the form of corporate profits—will clearly go to investors, not to farmers as cooperative patrons. Only if the farmers have invested in the corporation will they receive a portion of the profits, and then only to the extent of their share of the investment.

Members should carefully consider another significant change in the objectives of the organization. A corporation is generally obligated to maximize shareholder value, and this depends on the profitability of the business. A business that purchases from farmers and markets a product will maximize its profit by, among other things, paying the least amount for the product that will provide the supply needed. Thus, the corporation's motivation will not only be to distribute maximum profits to shareholders, but to minimize outlays to farmers.

Farmer-members are part of a community and support their community however they can. Indeed, a goal of many new-generation cooperatives is to benefit the community with added business and employment. Because a cooperative returns its benefits to farmer-members, all the income is returned to the community at a "working" level and is recycled in the community.

When a cooperative is converted to a non-cooperative, the profits are distributed to shareholders who may or may not be part of the community. Indeed, shareholder interests may be linked primarily to distant money centers. Even if the shareholders are from the community, the return received on their investment may not be put to work in the community as it would if received by farmers.

### **Other changes require similar questions**

A cooperative may make every effort to maintain its character and achieve some of the benefits perceived for non-cooperatives by establishing ancillary, non-cooperative, organizations. Entities may be established to handle non-member business, involve non-producer investors, expand operations beyond those related to member business, or

for a number of other reasons. There is nothing inherently objectionable about cooperatives making such business arrangements for the benefit of the cooperative and its members. The cooperative will run into trouble, however, when the arrangements are used to circumvent the cooperative's principles or to benefit someone other than the farmer-members.

Business dealings may also become so complex and intrusive in the cooperative's affairs that members and management lose sight of the cooperative's prime objectives. Members should pose many of the questions mentioned above to be sure the ultimate result is beneficial to members as producers.

### **Are the costs worth it?**

Another practice among some new cooperatives should prompt members to ask hard questions. NGCs are formed to add value to the farmer's product and capture the benefits of that value. In most cases, the NGC will need processing facilities and will operate the processing and marketing system. At the same time, that activity may well be beyond both the expertise and initial financial capabilities of the farmers as a group.

If so, it is necessary to look outside of the confines of a traditional local cooperative. The danger is that the expertise and up-front capital is purchased at an unacceptable cost to the cooperative.

The issue is far deeper than monetary outlay. Members should ask what the arrangement will do to the cooperative, and on what principles the cooperative will operate.

The clearest example of such a problem is where providers of a turn-key plant act essentially as promoters of an NGC and retain interests in its operations beyond a simple construction and sale of the plant. A company, or group of companies, may, for example, agree to build the plant on the condition that they retain a management role and share in the earnings, thus taking a share both of the benefits and the control that should be reserved for members. Clearly, members' questions are not limited to

short-term return on investment. Rather, members should explore long-term implications and carefully address all the issues presented by the cooperative principles mentioned earlier.

### **Time and place for members' questions**

This article has presented the type of detailed, important questions members should ask. But members must also recognize that there is a time and place for their questions. Unbridled and inappropriate inquiries can be detrimental to a cooperative and undermine the established (and legally mandated) role of the directors and management. Members should be guided by the familiar mantra of: "When? Why? Where? What? How? and Who?"

When members ask questions depends on circumstances, but in general the earlier the better. This is especially important when cooperatives are being formed and making the initial decisions about control, investment, financing and distribution of benefits. The time for questions may be mandated, such as when a major change in the cooperative requires direct member approval.

Members should be sensitive about why they are asking the questions. If they ask for personal benefit rather than for the benefit of the cooperative as a whole, or if they are asking not to gain legitimate information but to advocate a personal position, they are not benefitting the interests of the cooperative and fellow members.

We have discussed as some length what members should ask, which will depend on the circumstances. Members should realize that some information in a cooperative may be confidential.

The propriety of members' questions will also depend on how questions are asked. If they are confrontational, publicized, or accusatorial, they will not achieve their only legitimate purpose: to obtain useful information to respond to cooperative challenges.

Who should members ask? A cooperative's board of directors is assigned,

*continued on page 33*

# Adapting to change

*Educating members helps smooth transitions*

**Jim Wadsworth, program leader**  
*Education and Member Relations*  
*USDA Rural Business-Cooperative Service*

*“...the economic and social environment in which cooperatives operate is changing. As co-ops transform themselves to try and adapt to this new environment, the need for cooperative education becomes more and more critical. Co-op members need to understand the forces leading to the changes in their economic environment, while managers and boards need to think about the appropriate strategies their enterprise requires to survive and prosper in this new environment. And people in cooperatives need to be even more aware of how their organization fits into the world around them.”*

*From: “A Systems Approach to the Challenges Facing Cooperative Education and Cooperatives”*

*By Murray Fulton, Center for the Study of Cooperatives, University of Saskatchewan*

**T**his passage by Murray Fulton describes the critical necessity of educating members about the position of their cooperative in a rapidly changing business environment. This is especially important for cooperatives undergoing structural transformations. Fulton's words also address the need to ensure that members understand the economic forces impacting their cooperative, and how well they are positioned to respond to change. It advises managers and directors to be proactive in creating strategies for their cooperative's survival and prosperity.

Indeed, members must have a solid understanding of their cooperative's position in the marketplace and potential operational or structural changes that might be necessary to further extend or protect that position. Not only must directors and management understand the cooperative's current position, but they must be involved in developing strategic actions to protect and enhance that position. They then must communicate the rationale for these actions to members.

Some questions arise: How much do members currently

understand about their co-op's position? What information and how much information should be provided? How should it be delivered?

For cooperatives to remain strong, members must take their ownership responsibilities seriously. They must listen and ask tough questions of their leaders, offer their own ideas, be loyal to and financially invest in their cooperative.

Taking ownership includes having access to knowledge of how the cooperative is performing in its environment and its future direction. Ownership extends to knowing the circumstances that will determine a cooperative's future in a fast-changing and dynamic agricultural environment. Well-informed, active and engaged members are more apt to accept new initiatives.

Of course, not all planned strategic actions can be immediately communicated. In some cases, providing details of goals and strategy too early to the entire membership may be detrimental to a cooperative's well-being. Due to competition and other outside pressure, cooperative leaders may need to

be discreet about what to say in the early development stages. Significant advance work on a strategic action must be completed before information can be shared with the membership to indicate the cooperative's plans and how they will be achieved.

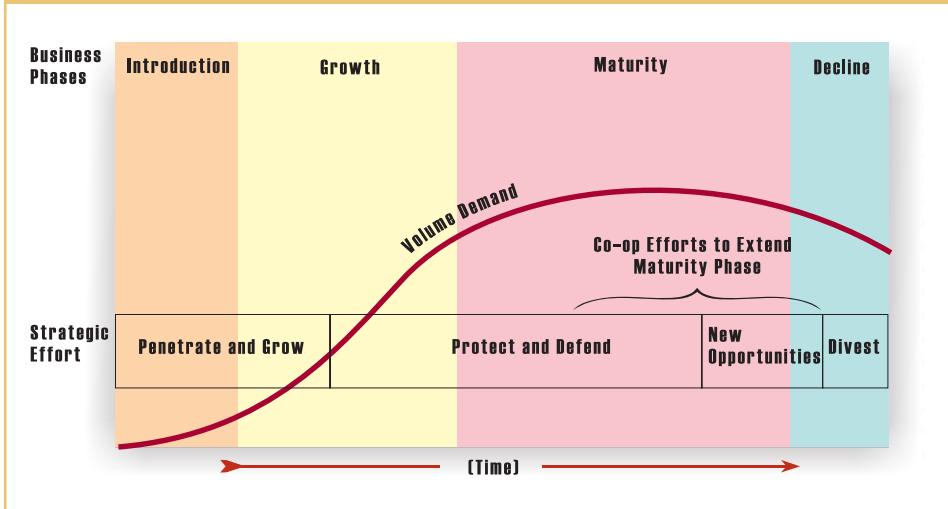
With that understood, it is still important that members not be blindsided by a significant strategic action taken by the board and management. At appropriate times, members should be informed of their cooperative's current position and planned future direction.

Detailed information on strategic efforts becomes especially important when cooperatives are making a structural change that the membership must eventually approve. For lesser plans, strong communication is still necessary because member distrust of the cooperative can arise if they learn of significant changes from outside sources.

If members are not appropriately informed in a timely manner, a backlash may develop and the board may find insufficient support among members for a needed structural change, such as closing a location or adding a new plant. Potential mergers, joint ventures



**Figure 1—Cooperative business life-cycle**



and other major changes may fail even after considerable work by management and the board. While there may be many reasons such efforts fail, the major reason is often a lack of understanding by members of why the action was needed.

#### Industry position

Members need to understand where their cooperative is positioned in its industry before they can support goals and strategic efforts to improve that position. Cooperative leaders must adequately explain the need for changes to operations and/or structure.

Figure 1 shows a life cycle for a cooperative business. The phases suggest that cooperatives develop strategies based on where they are in their business life cycle. Where they fall on the “S-shaped” curve depends on the present conditions in the marketplace and in their operations.

For instance, most traditional agricultural markets are considered mature markets. These mature markets are characterized by: slow to stagnant growth, strong competition for market share, declining farm numbers, growing size of surviving farms, service to repeat customers, greater emphasis on controlling costs and providing extra services, periodic excess capacity, lower margins and profits, diverse customer (member) interests, etc. Many agricultural entities, including cooperatives,

find that they are in this maturity phase of the business life cycle, requiring that they make strategic efforts to protect, defend and develop new opportunities.

Other cooperatives may be in emerging agricultural markets. For instance, new value-added (and new generation) cooperatives are apt to be in the introduction and early growth stages of their business life cycle. Consequently, these organizations should be working on strategic efforts designed to penetrate and grow.

Figure 1 also implies that cooperatives operating in mature markets often employ efforts to extend their existence along the maturity phase of their industry life cycle. This suggests that those cooperatives have been fairly conservative in their approach to internal and/or structural change over the years and implies that it is even more important for them to educate members as to where their organizations fit in their industry and where they may need to make significant strategic efforts to survive. This task is often difficult because members have become comfortable with the status quo.

Educating members on where their cooperatives fit in their environment and its business-life cycle leads to a more informed assessment of why the board has developed various goals and why it may be considering or pursuing a given change or strategy.

Figure 1 may help directors and

managers simplify the explanation of their cooperative’s industry position and associated strategic direction to members. Detailed aspects of operations, structure and the marketing environment must be explained so members understand the cooperative is indeed where they say it is on its industry life-cycle curve.

The figure may oversimplify the complexity of the cooperative’s position (because there are often many factors involved), but it still provides a reference point for directors to work from. Member understanding of their cooperative’s industry position can help clarify and build support for the goals and strategic efforts planned for by the board. Failure to make changes to improve a cooperative’s position may eventually push it into the decline (and potential divest) portion of the life cycle—not a positive outcome!

#### Strategic directions

Figure 2 is a model showing that environmental factors, such as industry trends and conditions and organizational conditions, impact a co-op’s ability to achieve goals. Cooperatives need to assess goal accomplishment and develop a strategic direction to improve their position. Indeed, industry conditions dictate that organizations look to plan, adjust and position themselves using alternative strategic directions for continued and improved goal accomplishment. Certain strategic directions will be more effective than others. They will also vary in the way they are constructed and implemented by different cooperatives given respective circumstances.

Figure 2 shows the major strategic direction of adjusting and making internal changes to operations and, perhaps, making internal structural changes (expansion or contraction of assets) in order to improve revenue streams, efficiency, scale economies, control of expenses, and organizational structure using leadership, niche and efficiency-related strategies. These changes fall under the efforts to extend life-cycle phase in figure 1.

This direction is not new to cooperative leaders. Cooperatives have traditionally and consistently looked to grow by improving operations for greater member benefit and efficiency. This direction has been employed in various ways by many cooperatives for extending their life cycle in mature market environments.

However, simply improving operations on a recurring basis is not always enough. Industry conditions and the cooperative's performance toward achieving goals often push cooperatives to make more significant external changes as an extension of their original structures. In fact, some cooperative leaders have been saying that looking to external structural strategies

Joint ventures, agreements, alliances and working relationships are common among farmer cooperatives. They are strategies for gaining or restoring growth while limiting the investment given the cooperation of the enterprises involved. Though not as severe of an organizational change as unification, these strategies warrant careful study by cooperative leaders.

Unification (i.e., merger, consolidation, acquisition) is a strategy that many cooperatives look to for accomplishing growth goals and improving competitive position, and in some cases for survival. Because unification drastically changes the organization—altering cooperative culture, internal and external structure, governance, asset

and management to develop appropriate strategic effort, but communication aspects as well.

### Communication issues

It is extremely important to communicate to members about their cooperative's current position in its industry and how its position is affected by the cooperative's mission, vision, values, goals, and propensity to continue benefitting members. Additional communication is needed on strategic effort—the likely changes the cooperative is planning or contemplating to improve its position.

For internal changes, members need to be told what is being planned and how it will affect them and the cooperative. Directors and managers need to explain whether the change will expand or scale back services in a certain area to help the cooperative achieve better financial performance or industry position.

For a unification, members need to understand precisely why the change is being considered. Inaccurate information can create controversy and negative perceptions. Members must be made aware of why the unification is important and how it will affect the cooperative. This may lead to further actions, such as vertical or horizontal integration, the advance of scale economies, expanded capacity and potential synergies and efficiencies, etc. These must all be clearly described.

The same holds true for potential joint ventures, strategic alliances, working relationships and marketing agreements. Members need to receive accurate information and be told precisely what the strategic action will mean to them and their cooperative.

Members must understand why it is in the best interest of the cooperative (the goals the change will accomplish). They need enough information to objectively assess the change. Feedback and comments from members should be welcomed. Communication must be two-way: the board and management need to listen as much as they talk.

Visual aids—such as figures 1 and

*continued on page 33*

**Figure 2—Strategic positioning/planning model**



—acquisitions, mergers, joint ventures, alliances, etc.—is critical if cooperatives are to stay competitive in a consolidating agriculture industry.

Figure 2 shows two external structural change strategies that extend beyond the normally employed strategic direction of internal adjustment and improvement. Cooperatives have two basic directions to consider: (1) build working relationships—develop joint ventures, strategic alliances, or other business relationships with other cooperatives or companies (to help put the cooperative into the growth and new opportunities phase of figure 1), and (2) unification—mergers, consolidation or acquisition (which can also put a cooperative in the growth and new opportunities phase).

base, services and membership boundaries—cooperative leaders have to be diligent in studying and making decisions of this significance.

Structural change strategies must be contemplated by cooperative leaders interested in protecting competitive position or improving cooperative value by seeking greater market share, vertical or horizontal integration, diversification of services and other growth opportunities.

Figure 2 provides a strategic planning overview for cooperatives. It shows relationships between goals, environment and potential strategic directions. Cooperatives work to close the gap between their mission and vision by execution of strategy. Execution involves not only work by board



## Foremost sales top \$1.3 billion; income steady at \$10 million

Foremost Farms, Baraboo, Wis., saw sales rise from \$1.1 billion in 2000 to \$1.3 billion in 2001, although net income of \$10.1 million remained virtually unchanged. "Commodity markets remained volatile, with strong prices for the first three quarters followed by steep drops during the final quarter of 2001," said Duaine Kamenick, finance vice president. Average milk price climbed \$3.35 per hundredweight (cwt) from \$11.62 in 2000 to \$14.97 in 2001.

President Dave Fuhrmann said the cooperative will distribute \$10.1 million in patronage to members, or an average of 21 cents per cwt, with 25 percent of it in cash and the balance added to member equity accounts. The cooperative's ownership ratio (total equities divided by total assets) interest was 46 cents to \$1, compared with 49 cents to \$1 for 2000. The co-op's primary products are cheese, liquid and condensed milk products, and packaged milk products. Reinvestment for capital improvements to facilities, machinery, equipment and technology topped \$44 million, up from \$32 million in 2000. "There isn't another company in the Midwest, private or cooperative, that has made the investments we have for the long haul," said Fuhrmann.

## 2001 revenue & income climb for Minn-Dak

Total net revenue for Minn-Dak Farmers Cooperative, Wahpeton, N.D., reached \$177.9 million for fiscal 2001, up from \$170.1 million in 2000. Sugar sales accounted for \$167 million

## MFA Inc. hosts President Bush

President George W. Bush spoke to a crowd of 900 people who gathered in the warehouse at MFA Inc.'s feed mill in Aurora, Mo., in January. President Bush's remarks focused on the need for economic stimulus, especially as it relates to agriculture. "If we're talking about the economic health of the country, we've got to always understand it begins with a healthy farm economy," Bush said.

He also stressed the need for a trade policy that boosts exports of American agricultural products. "If you're the best in the world at what you do—which we are in farming—then it seems to me we ought to encourage that product to be sold not only here in America, but to level the playing field so it can be sold across the world."

The president also touched on the war on terrorism. "If the goal of government is to create an environment in which people are willing to take on risk, one of the things the government must do is work hard to create confidence in the people." Bush said the best way to do that is to "prevent the evil ones from hitting us again."

The cooperative did not have much time to plan for the event, said Joe Powell, vice president of the feed division of MFA, a marketing and farm supply co-op that serves 45,000 active members in Missouri and adjacent states. "Our employees all pitched in with enthusiasm and pride, working extra shifts over the weekend to get ready for the president's visit," Powell said. "We all felt honored. We also felt both pride and relief that this event came off so smoothly." ■

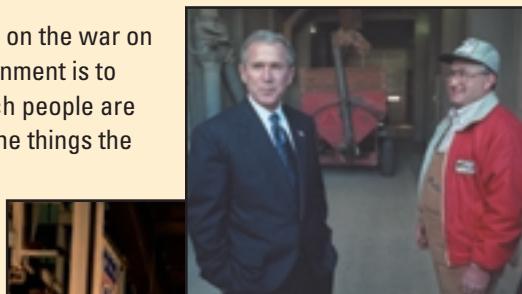


Photo by James Fashing, Courtesy MFA Inc.'s "Today's Farmer" magazine

Top: U.S. White House Photo by Eric Draper

of the 2001 total, up \$25.5 million from 2000. Net income was just under \$5 million, up sharply from \$316,000 in 2000. The cooperative harvested 2.06 million tons of beets from 94,900 acres and sliced 2 million tons.

David Roche, the cooperative's new CEO, told members, "Our shareholders recently received their final payment of \$89.6 million for the 2000 crop, the result of doing the right things right." He said the cooperative needs to remain focused on its core business and to control costs.

Meanwhile, Tom McKenna, CEO of United Sugars Corp.—the sugar marketing-agency-in-common of Minn-Dak, American Crystal Sugar Corp and Southern Minnesota Beet Sugar and cane sugar companies—said NAFTA-related trade issues with Mexico present a major challenge for the domestic sugar industry. United Sugars plans to market liquid sugar made by its member refinery in Florida. Its expansion will be completed this fall.

#### **National Grape says Welch's not for sale**

Whether it was just a long-term planning business exercise or a test of the financial market to see what someone might offer, the National Grape Cooperative has issued a strong "no thanks" in regard to the possibility of putting Welch's Foods and its world-famous brand grape products on the trading block. The board announced its unanimous decision in February that Welch's is not for sale.

Speculation had gone so far as to suggest what interested grower-owners might net from a sale, based on their tonnage and acreage. Figures in the hundreds of thousands of dollars—reaching more than \$1 million in many cases—were being discussed. The mere suggestion stirred deep emotions and long-held loyalties, traditions and family histories.

The board of directors, elected to represent the more than 1,400 growers in New York, Ohio, Pennsylvania, Washington State, Michigan and

Ontario, met in Erie, Pa., and decided the sale was not in the best interest of the membership. President Fred Kilian noted that discussions about the sale of Welch's have occurred from time to time over the decades. But he quickly pointed out that the cooperative was neither on the market nor considering any offers. He said the board would not entertain any such ideas unless backed by a majority of the membership.

The cooperative has owned Welch's since 1952, although the firm's history goes back to 1869. The cooperative's origins stretch back to the Great Depression, when Jack Kaplan, an eastern businessman, formed National Grape Corp. He helped create the present cooperative in 1945 by merging smaller cooperatives.

Welch's owns processing plants in Michigan, New York, Pennsylvania and Washington. Financial pressures in the farming business have been taking a toll. Area growers suffered one of their worst seasons last year, when production fell 67 percent from 2000 due to wild temperature swings last May and June. Growers also are concerned about imports. They see the apple industry in a state of upheaval caused by 5 years of the Chinese dumping vast quantities of frozen apple juice concentrate on the market. There are similar fears regarding grape juice from Argentina. Some felt the sale could spell the end of a prosperous U.S. Concord grape industry.

The cooperative guarantees it will buy members' grapes. But in turn, members must meet Welch's standards for grapes regarding sugar content and other qualities and must sell their grapes only to the cooperative.

Sales last year reached \$650 million, up from \$419 million a decade earlier. Last November, Welch's cut 50 jobs when it closed its general offices and old corporate headquarters at Westfield, N.Y. The company employs more than 1,300 people.

#### **Sales record set by Diamond Walnut**

Diamond of California, a walnut-growers' cooperative at Pleasanton, Calif., reported a banner performance for 2001 with its third consecutive year of double-digit growth. Record gross sales of \$307 million were recorded, up 15 percent from 2000. Net proceeds were \$133 million, up from \$125 million. Earnings for grower-owners increased 32 percent, on a price-per-pound basis, from fiscal 2000. Factors contributing to the strong performance were expanded product offerings and marketing initiatives that helped to build demand.

Diamond has introduced new items in its Harvest Reserve line of nuts, including pecan halves and whole almonds. The co-op says the product line features premium nuts with superior color, texture and flavor. Diamond is expanding its product line to include even more premium nuts suited for home meals, baked goods and on-the-go snacking.



*Diamond Walnut's latest addition to its Harvest Reserve product line. Photo courtesy Diamond Walnut*

In other news, Diamond of California Chairman John J. Gilbert received one of two director of the year awards from the National Council of Farmer Cooperatives, presented during its annual meeting in Orlando. His award was for a director with more than 2 years experience.

#### **CHS opens stock offering**

A rare public stock sale by a prominent agricultural cooperative is underway in the Upper Midwest under the auspices of CHS, Inner Grove Heights,

Minn. CHS, recognized in many rural communities by its red and white bow-tie logo, seeks to raise \$50 million by selling preferred, non-voting stock at \$1 per share (\$1,000 minimum) at 8 percent annual interest. This is the first time in the cooperative's history that it has gone outside the membership or cooperative system to raise capital. Most often, cooperatives generate capital by holding member equity for later payment or borrowing from CoBank. The money will be used to pay down short-term debt and make cash available for growth and other uses. Eventually, the cooperative may use changes in the federal law which permit it to convert member equity into preferred stock.

Last year, CHS had sales of \$8 billion and net income of \$178 million. It provides 1,200 member co-ops owned by 350,000 farmers with farm production supplies, grain marketing and food processing services.

#### Agway to sell four divisions

With an eye toward improving profitability by concentrating on its core business, Syracuse-based Agway Inc. has announced plans to sell four divisions not directly related to its farm production supply business. The businesses are: Telemark (leasing), Agway Insurance, Seedway and its agronomy business. Spinning off the agronomy and seed businesses are an aftermath of Agway shifting many retail farm stores to Southern States in recent years.

Being retained are animal feed and nutrition, energy products, fresh produce and agricultural technology units. "These businesses have combined annual sales exceeding \$1 billion (75 percent of the co-op's total annual sales) and they have a clear history and connection to our farm and cooperative heritage," said Agway CEO Donald Cardarelli.

#### Farmer co-ops registering .coop Internet names

Corn-er Stone Farmers Cooperative (see page 14 for more on this co-op) is one of a number of ag cooperatives staking out addresses on the Internet's new ".coop" domain. Corn-er Stone, a

farmer-owned ethanol co-op in southwestern Minnesota, has registered a number of generic names, including: ethanol.coop, corn.coop and wind.coop., as well as cornerstone.coop. Corn-er Stone manager David Kolsrud, who says he believes the Internet is a good way to increase the visibility of value-added processing cooperative ventures, acted quickly to register the names.

The National Cooperative Business Association, which oversees the .coop domain, reports that other ag cooperatives that have registered .coop names include: Ag Processing Inc., Agway, Cabot Creamery, CHS, Growmark, Sunkist, Grainland Cooperative, Minn-Dak Farmers Cooperative, Knouse Foods, National Co-op Refinery Association and West Central Cooperative. More than 40 percent of the 1,200 U.S. rural utility cooperatives and some 800 credit unions were among the early registrants. NCBA estimates that, worldwide, 750,000 cooperatives serving about 760 million members are eligible for the .coop Web address.

It costs \$80 per year to register a .coop name, with an initial 2-year minimum purchase required. The fee enables NCBA to ensure that only true co-ops register as such. To buy .coop names, go to [www.coop](http://www.coop). If you have questions or need registration assistance, e-mail the dotCoop Operations Center at: [support@communicate.coop](mailto:support@communicate.coop), or call (toll free) (866) 288-3154.

#### DFA grows in bold moves

"A fourth consecutive year of strong financial performance coupled with strategic moves positions Dairy Farmers of America (DFA) to continue to grow and serve dairy farmers," CEO Gary Hanman told delegates at the recent annual meeting in Kansas City. In one bold move, he said, DFA sold its largest asset, a 33.8-percent share in Suiza Food Group, reinvesting the proceeds into a 50-percent share in the new National Dairy Holdings (NDH). By year end, NDH had grown to be the nation's largest privately held fluid milk operation, with 28 bottling plants. The equity interest in NDH "gives us

even wider market opportunities and a tremendous growth vehicle." DFA remains a major supplier of the new Dean Foods Co.

In 2001, DFA sales climbed from \$6.7 billion to \$7.9 billion and assets from \$1.9 billion to \$2.1 billion. The cooperative marketed a record 28 percent of the nation's milk, or 45.6 billion pounds, even while nationwide production declined. Average price paid to members was \$15.22 per hundred-weight, up \$2.58 from 2000.

Meanwhile, DairiConcepts, a joint venture between DFA and NZMP, the ingredient business of New Zealand's Fonterra Cooperative Group, is being expanded to produce an extensive range of ingredients at Portales, N.M. It will



Through its Borden brand, DFA is a leading innovator in new cheese products.

Photo courtesy DFA

be the first commercial producer of milk protein concentrates (MPC) in the United States. It will also produce other dairy ingredients for many markets in the fast growing convenience food sector. DFA will provide the plant's milk supply.

In other developments, DFA's American Dairy Brands division has introduced Borden fresh shredded cheese and macaroni dinner, which will be found in the dairy case of supermarkets. It will be backed by an aggressive radio advertising campaign.

# GROWMARK "Shares the Spirit" to mark 75 years of co-op service

GROWMARK has launched an extended celebration of its 75th anniversary as one of the nation's leading cooperatives. Events will culminate Aug. 28-29 at the regional cooperative's 2002 annual meeting in Chicago. Theme for the festivities is "Share the Spirit, Share the Dream." Today's GROWMARK farm supply and grain marketing system serves local cooperatives in Illinois, Iowa and Wisconsin and the Canadian province of Ontario.

GROWMARK's roots go back to 1926, when farm power was being converted from horses to tractors. That created a need for gasoline, kerosene and lubricating oil. Farmers were having difficulty finding a reliable supply of petroleum products. Major oil companies had little interest in serving sparsely populated areas because it increased their operating costs. So farmers in nine Illinois counties formed the Illinois Farm Supply cooperative to gain greater control, purchase a larger volume and ensure a consistent supply of vital petroleum products. In time, the product line would be greatly expanded into other farm supply commodities. Its farmer-members gained a market for their grain and obtained related services.

"Our mission remains virtually unchanged from 1927," says Bill Davisson, GROWMARK's chief executive officer. "Although technologies and services have changed, our goal continues to improve the long-term profitability of our member-owners. Creating innovative ways of meeting needs and exceeding expectations is what the past 75 years has been about—and our charge for the next 75 years and beyond. Our vision is to be the best agricultural cooperative system in North America."

In line with consolidations in farming and supporting agribusiness, mergers continue within GROWMARK's system, both on the local and regional level. Nearly 2 years ago, for instance, a trio of locals in the heart of the Illinois grain belt—McLean County Service Co., Woodford FS and Livingston Service Company—formed Evergreen FS. Its sales from 6,200 farmer-members last year topped \$100 million.

Like its local co-op members, GROWMARK has grown as well, into a farmer-owned company with \$16.3 million in earnings and \$1.3 billion in sales. The system employs 400

people at its Bloomington headquarters, another 236 throughout the Midwest and 106 in Canada.

Meanwhile, the National Council of Farmer Cooperatives has honored Dan Kelley, GROWMARK's chairman of the board, with its director of the year award during the council's recent annual meeting. He was cited for his understanding of his cooperative, good leadership and

business judgement and the ability to effectively communicate. Kelley farms 2,300 acres of corn and soybeans in partnership with his two brothers near Normal, Ill. He has been on the regional board for six years and its chairman since 2000. He is only the sixth person in the cooperative's history to lead the board. Kelley also heads the board of Evergreen FS, one of the regional's member companies.

GROWMARK is also making efforts to encourage environmentally sound farming practices. It plans to supply \$15,000 in grass seed and other funds to boost conservation efforts in Illinois and Iowa. Vice President Vern McGinnis signed agreements with Trees Forever, which has developed Illinois and Iowa buffer partnership programs. The program

promotes voluntary efforts to plant and maintain grass conservation buffer strips along streams, rivers and other waterways. Buffers improve water quality by trapping up to 90 percent of sediment and 80 percent of nitrogen contained in surface water runoff. "Our cooperatives are committed to earth-friendly agriculture," McGinnis said. "For years, we have supported conservation efforts that promote clean air and water, encourage healthy wildlife populations and ensure long-term productivity of the land. As proactive environmentalists, our farmer-members live on the land and have a vested interest in keeping it clean."

GROWMARK has also long been known for its commitment to cooperative education, through efforts such as an essay contest that asks FFA members in Illinois, Iowa and Wisconsin to write about the cooperative way of doing business. GROWMARK and FFA have sponsored the contest for the past 9 years. A winner from each state earns a \$300 scholarship, as do their FFA chapters. Aside from improving writing skills, the contest increases understanding of current issues in agriculture and the cooperative way of conducting business.



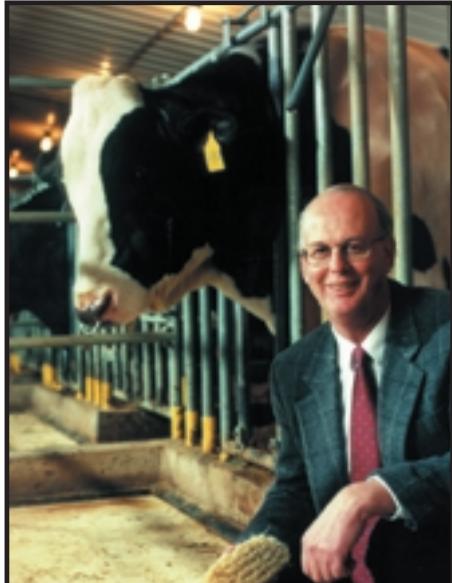
*GROWMARK Chairman Dan Kelley, right, receives the NCFC Director of the Year award from Don Schriver of DFA (center) and 2001 award winner Jack Hardesty of Maryland-Virginia Milk Producers.*

## Wilson succeeds Lyon at CRI

R. Douglas Wilson has been named as new chief executive officer at Cooperative Resources International (CRI), Shawano, Wis. He succeeds Tom Lyon, who retired March 1. Chairman Roger Borgwardt said Wilson had considerable experience in the dairy and livestock industry and "proven leadership capabilities in the cooperative businesses." Most recently, he had been chief operating officer of CRI's cattle breeding subsidiary, Genex Cooperative.

Wilson credited Lyon with leading the co-op through "the most significant era this organization will experience. He was the architect and accepted the challenge of proving his worthiness to the cooperative world."

Wilson served as president of the National Association of Animal Breeders, the artificial insemination industry's trade association, for 3 years and held a similar post with the Wisconsin Federation of Cooperatives, which has honored him with its cooperative builder award. The World Dairy Expo named him its industry person of the year in 1993. He currently serves on



R. Douglas Wilson and friend.

the Wisconsin state fair park board and the food and environmental sciences advisory board of the University of Wisconsin-River Falls.

## 'New Cooperative Horizons' NICE theme for Chicago

Challenges and opportunities facing cooperatives in a highly competitive environment will be examined under the theme of "New Cooperative Horizons," during the 74th annual National Institute on Cooperative Education (NICE). The event will be held in Chicago Aug. 5-7. The NICE program will center around 15 sessions examining topics such as: how cooperatives can benefit from mega trends in agriculture and the food system, Brazil's position in international trade, and implications of domestic farm policy changes for cooperatives.

Other topics include: the role and future of the Chicago Board of Trade; the role and responsibilities of co-op audit committees and benefits derived from agricultural and cooperative research. Other sessions will examine the economic outlook for U.S. and world economies, the importance of business relationships, challenges of financing cooperatives, home-grown fuels and U.S. energy policy, employment laws and issues and the evolving food system.

For registration information, contact: Tom Little, NCFC Education Dept., 50 F St. NW, Suite 900, Washington, D.C., or phone (202) 626-8700, or visit the NCFC Web site at: [www.ncfc.org](http://www.ncfc.org). ■

### CF Industries honors four watershed groups

The Conservation Fund has announced that four watershed groups are the recipients of the 2001 CF Industries National Watershed Awards. Each recipient has demonstrated effective, non-regulatory approaches to improving water quality. The winners are:

- Duck Creek Watershed Management Project in Juneau, Alaska;
- Tri-State Water Quality Council, Sandpoint, Idaho;
- Riverland Conservancy, Madison, Wis.;
- Lake Champlain Water Basin Program, Grand Isle, Vt.

"These recipients demonstrate that great things can be accomplished to improve our watersheds through leadership, cooperation, commitment and innovation," said Robert Liuzzi, CF's president and chief executive officer. The winners were recognized for stream and wetlands restoration, reductions in runoff pollution, building partnerships, community outreach and education. CF Industries, which is owned by nine regional cooperatives to which it distributes fertilizer products, originated the award in 1996. It annu-

ally recognizes three communities and one corporation for their water conservation efforts.

### Ocean Spray, Nestle in bottling venture

A cost-cutting, long-term bottling alliance has been formed by the Ocean Spray cranberry cooperative and the U.S. division of Nestle S. A., the Swiss beverage company. The cooperative will bottle two Nestle beverage lines and together the firms will buy packaging and ingredients and establish an economy of scale that will boost mutual profitability. An Ocean Spray spokesman said the pact should not be considered a prelude to the possible sale of Ocean Spray to Nestle. Members voted down a proposal in 2000 to sell the cooperative, which some members had suggested because a cranberry glut was depressing grower prices. Ocean Spray recently announced the sale of its Nantucket Nectars business, which it purchased in 1997, to Cadbury Schweppes so the cooperative can concentrate its attention on the cranberry juice business, particularly the new white cranberry juice.

## Co-op buys Michigan Sugar

Sugarbeet growers—more than 1,000 strong and organized as Michigan Sugar Beet Growers Inc.—have completed purchase of Michigan Sugar Co. at Carrollton, Mich. The \$64.5 million sale took 2 years of negotiations with the owner, Texas-based Imperial Sugar Co. Later this year, the cooperative's 1,038 members from 11 counties will elect a new 11-member board of directors. Imperial was paid \$29 million in cash, \$24 million of it raised from the sale of stock to the grower-owners. The remaining cash came from a 5-year loan from the state of Michigan. The cooperative will still owe Imperial for a 10-year, \$16 million loan at 8 percent interest and will begin repaying \$18.5 million in Michigan Industrial Development Bonds at 6.5 percent interest in 2015.

Sugar produced by the cooperative under the Pioneer brand will be marketed by Imperial for the next 10 years. The pulp and molasses will be marketed by the cooperative. Processing facilities are centered in Michigan, Ohio and Ontario. Mark Flegenheimer is president and chief executive officer of the cooperative, which will hire 350 full-time and 1,000 seasonal employees.

## Farmers Union turns 100 "still fighting for producers"

The National Farmers Union, founded in 1902 as the Farmers Educational Cooperative Union of America, is marking its 100th birthday in the same way it started out: working to enhance the competitive status of its 300,000 members in 24 states. It recently announced it will ask Congress to investigate whether big investors and multinational companies are manipulating grain and livestock markets to the detriment of producers. Farmers Union says it wants to know why grain markets don't seem to rise when supplies tighten, which it blames on large investors who can cause the market to rise and fall in a short time period. It is also seeking a moratorium on patents for new, genetically modified organisms.

When Farmers Union started, it was

illegal to form a union for negotiating commodity prices, so it pushed for new laws to protect the nation's small farmers and rural communities. One of the organization's priorities is to promote development of cooperatives and communications technology.

At its recent, 100th annual meeting in Irving, Texas, members elected David Frederickson, a former state senator from Roseville, Minn., as its new president. He succeeds Leland Swenson, a long-term advocate of cooperatives during his years as president. Some 20 buses were used to take those attending the meeting to Point, Texas, to visit the organization's first meeting place. There they installed a plaque at the cemetery where some of its founders are buried.

The words of Farmers Union founding member Newt Gresham, quoted in a 1902 newspaper article, were recalled during the event: "With their bare, calloused hands and strong backs, the farmers converted the countryside from a wilderness into fertile farmland. Now the farmer is hurting, and being manipulated. We need a voice. We need an organization to fight for the rights and survival of family farmers. That's why we founded Farmers Union. This is just the beginning."

## Mandan co-op gets new lease on life

The slide started a couple years ago when grain being stored at Mandan (N.D.) Farmers Elevator spoiled. The cooperative lost a load of money, and its bonding and warehouse license was lost in May 2000. A summer stock sale meant to rescue the co-op fell short. The Main Street fixture was put up for sale, but nobody would buy it, and members voted to dissolve the cooperative.

Later, however, they recanted and conducted another stock drive that raised \$97,000. The Mandan city commission approved a \$25,000 loan from its growth fund in December and another \$13,000 in January. Farm Credit Services of Mandan offered a line of credit. The financing and grants enabled the cooperative to regain its

license. The co-op's grain and feed business have now both resumed. Jeff McGregor, credited for turning around another elevator, has been hired as the new general manager.

## Kansas co-op leader honored for service

The Kansas Society of Association Executives has honored Joe Lieber, president of the Kansas Co-op Council since 1986, as its association executive of the year. Lieber was cited for his excellence in leadership and participation in association activities. He served on the society's board for 10 years and as its president in 1999. In 2001, he was selected as Kansas association executive of the year. Lieber serves on the board of directors' executive committee for both the National Council of Farmer Cooperatives and National Cooperative Business Association; advisory committee of the Arthur Capper Cooperative Center at Kansas State University; charter member of the national Rural Cooperative Task Force; past president of the Council of State Cooperative Councils and Kansas Cooperative Alliance; and a director of the Kansas Chamber of Commerce and Industry, for which he has conducted more than 600 radio interviews on the council's AgByline program.

## Co-op Hall of Fame inducts three

A prominent cooperative attorney, a farm organization executive who promoted cooperative development and the chief executive officer of an inter-regional farm supply cooperative were inducted into the national Cooperative Hall of Fame in Washington, D.C., April 24. The Cooperative Development Foundation administers the program. Honorees, whose contributions to cooperatives were considered "genuinely heroic" include: Ralph K. Morris, who died in February 2002. The nation's leading cooperative attorney, he served as legal counsel for three decades for Cooperative Resources International (CRI) at Shawano, Wis., the first holding cooperative in the

United States, which he developed. He also helped create numerous new-generation cooperatives and was pivotal in restructuring countless cooperatives to improve their operations.

C. William Swank is the former executive vice president of the Ohio Farm Bureau Federation who spent 40 years strengthening the economic vitality of farmers through cooperative action. He was a tireless educator who extolled the virtues of cooperatives and encouraged others to embrace them, teaching directors, youth and farmers alike. He also helped found Cooperative Business International, which provides international trade opportunities for U.S. cooperatives.

Francis L. Lair helped found Universal Cooperatives, an interregional farm supply cooperative, and was its first chief executive officer. Lair devoted more than 40 years to cooperatives, served on the board of MSI Insurance and National Cooperative Business Association and worked closely with the Minnesota Association of Cooperatives and Group Health Mutual Insurance Co.

#### **Gold Kist fêtes egg farmers**

Atlanta-based Gold Kist Inc. recently presented its first annual producer of the year award to Brickle Egg Farm, owned by Thomas and Andy Brickle of Cope, S.C. Chairman Dan Smalley said the award was originated because the cooperative was refocusing on its poultry business and the importance of producer-members in it. The Brickle Egg



Thomas and Andy Brickle were selected as Gold Kist's' producers of the year from the co-op's more than 2,000 producers. Photo courtesy Gold Kist

Farm was chosen by the board's member relations committee from nominees in Gold Kist's nine divisions and more than 2,300 poultry producers. Award criteria included performance in the division, poultry housing conditions, community involvement, environmental management and support and advocacy of Gold Kist. The Brickle's operation has a capacity of 27,000 hens producing 4 million eggs per flock. The award carries a \$1,000 cash prize.

#### **Farmland to sell Tradigrain; joins in wheat sale to Cuba**

Citing the need to concentrate more on its core business, Farmland President Bob Honse has announced the sale or closing of Tradigrain, the cooperative's international grain trading subsidiary. Less than a year ago, Farmland developed a joint grain venture partnership with Archer Daniels Midland (ADM), a major international grain marketer. Tradigrain has less than 100 employees in 11 countries, including an office in Memphis. Farmland purchased Tradigrain in 1993 and its investment was paid off in the first 5 years. Honse said Farmland wants to concentrate on serving its local cooperative owners through marketing joint ventures in farm production supplies and grain and developing its meat business.

In other Farmland news, the co-op recently participated with ADM in the \$9.4 million sale of hard red wheat to Cuba. This was the second shipment since Jan. 1.

Farmland has also agreed to sell its feed phosphate operation in Joplin, Mo., to Potash Corp. of Saskatchewan (PCS), the world's largest fertilizer company. Farmland had owned the Joplin plant for almost 50 years.

#### **Dakota Growers Pasta eyes conversion to C-corp.**

Dakota Growers Pasta in Carrington, N.D., which has been looked to as a model new-generation cooperative, plans to ask its members to vote on whether to convert their cooperative into a

privately held corporation. The co-op's board, which voted to recommend the change to its more than 1,100 members, says the change is needed both to bring in more investment capital and because members' ability to grow durum wheat has been reduced by poor weather and plant disease. As a result, members have increasingly been purchasing durum from a non-member wheat pool, threatening the cooperative status of the business (which, by law, must receive at least 51 percent of its input from members).

At press deadline for this magazine, the proposal was being reviewed by the Securities and Exchange Commission. The process for the conversion—if approved by the SEC and members—is fairly complex, involving the creation of three new subsidiaries, two of them registered in Colorado, which, unlike North Dakota, permits a co-op to convert into a corporation.

An article in the April 8 issue of "Ag Week" newspaper quotes co-op members and others who have concerns about the proposed conversion, including Roger Johnson, North Dakota agricultural commissioner. Johnson is quoted as saying he fears the change to a corporate business structure would undermine the goals of the new-generation co-op movement, which is to help producers offset low commodity prices with returns from processing their crop. "(In a corporation) the loyalty is to the stockholder, who is going to demand a high rate of return. That will come at the expense of the price you're able to pay for durum wheat," he is quoted as saying. If the co-op goes corporate, "it's going to be much harder to get producers to invest in another value-added venture," he told "Ag Week."

#### **Crestland co-op assets sold**

By upping its earlier auction bid to \$6.5 million for the bulk of Crestland Cooperative's facilities in southwestern Iowa, DeBruce Grain of Kansas City quieted objections from five bondholders, who held part of Crestland's debt of \$16.5 million owed to major creditors. A recent auction raised only \$10.5

million. Some of the northern tier facilities were purchased by local area cooperatives. An attempt by some former members to form a replacement cooperative to purchase some elevators failed to raise the needed money.

At one point, the 70-year-old Crestland cooperative had 225 employees, 17 business operation locations and 2,500 members. It had expanded beyond its original grain business into construction, a home improvement store, real estate and a \$22 million soybean processing plant. The Iowa

Indemnity Fund paid up to 90 percent of farmer claims for unpaid grain delivered to Crestland.

### Trying, positive year for Tenn. Farmers

Fiscal 2001 was trying, but also positive for Tennessee Farmers Cooperative. It reported the first loss—\$7 million—in the regional cooperative's history. Overall sales topped \$430 million, consistent with budgeted projections, said Chief Executive Officer Vernon Glover.

The loss was largely due to accounting problems and replacement of a software program to better serve its member cooperatives. The program had been causing daily problems, he explained, and in the end it had to be replaced with a modification of the original system.

On the positive side, TFC returned \$6.4 million in cash to members and sold near-record amounts of fertilizer. Its crop protection products sales volume grew with the introduction of more generic products. TFC also

## Ask the right questions *continued from page 22*

by law, responsibility to establish the cooperative's policies. Members must not undermine the board of directors, either directly or by planting doubts and dissension among members. When members have questions, the board has most likely already considered the issue. The best practice is to inquire of the board of directors first. If the board perceives a deficiency in communication generally, it may establish procedures for handling questions in the management system.

To re-emphasize: members should clearly understand that the board of directors they selected establishes the

cooperative's policy as representatives of members.

### The positive approach

In today's economy, cooperatives cannot be static or slow to act. Change is in the air, and cooperatives need a positive, dynamic and creative approach to the markets in which they operate. The type of inquiry suggested in this article is in no way intended to restrict creative, rapid, significant or effective response to the needs of the marketplace. To the contrary, this type of questioning is positive, not negative; it is forward-looking, not reactionary. But

these questions are vitally important.

Perhaps change—even significant change—in the cooperative is due. It may be time for a new look at structure, operating methods, bylaws or policies. Perhaps a substantial response to dynamic market forces is indeed required.

The central focus of members' interest in the future of their cooperative—the basis for questions discussed here—is to preserve the value, and values, of their cooperative so it can benefit its members as producers of agricultural products in the manner mandated by fundamental principles of cooperation. ■

## Adapting to change *continued from page 25*

2—can be used to present the general view of a cooperative's situation and plans for the future. For more specific details, members should be provided with additional information about the precise circumstances confronting the cooperative and critical aspects of the strategic efforts being considered or implemented.

### Failures point to need for stronger effort

The cooperative transformations that Fulton describes are occurring in the cooperative business world today and these circumstances beg the question: How well are cooperatives com-

municating these transformations to members? While many have surely done a good job, evidence of failed cooperative strategic efforts (e.g., unifications, joint ventures) suggests that good communication with members isn't pervasive in the cooperative arena.

Communicating cooperative industry position and concrete reasons for strategic action may not always yield the results the board intended. Members may resist significant change for other reasons. However, it remains critical that the board and management be forthright and informative to members about where their cooperative fits in its industry and what types of strate-

gic efforts may be needed for better positioning in the short and long term.

As Fulton prescribes, "...members need to understand the forces leading to the changes in their economic environment...." Members must also understand what their cooperative needs to do to counter such forces to thrive and survive. As owners, members must be educated and knowledgeable about such matters. It is their responsibility to work toward that end as well as the responsibility of directors and managers to provide members with critical information to level the learning curve. Meeting these responsibilities head-on is an imperative for the future of cooperatives. ■

increased its share of the seed market. Several member cooperatives are building new stores and 18 others are renovating or remodeling existing stores to display more inventory and add new product lines. Tire operations were expanded into 18 co-op outlets in Tennessee. Under the Ag Equipment umbrella, its newest department,

equipment is being sold in 25 states with expansion into other states likely. Cooperative marketing efforts in Arkansas also have been successful.

In the officer election, the board chose Johnny Daniel of Charlotte, Tenn., as the new chairman. Eddie Wilson of Cleveland, Tenn., succeeded Daniel as vice chairman.

## Correction

The authors of the article on the Tree Top apple cooperative in the March-April 2002 issue of "Rural Cooperative" were: Carmi Lyon, Cathy Durham and Steve Buccola, all of Oregon State University.

### Getting the green light *continued from page 19*

feasibility study outlines differently, you should plan on raising between 40 percent and 60 percent through your membership. However, for some projects, it may be necessary to raise 125 percent of the total needs. The extra 25 percent is necessary to help carry the new venture as it begins to establish its brand.

The final monetary component of a comprehensive business plan is the cash flow, or capacity. Capacity depends on several factors:

- What are the economic conditions?
- What does the competitive marketplace look like?
- What's the need or demand for the goods and services sold?
- Are there, or are there going to be, technology changes?
- What's the government going to do?
- What's the cycle of the industry?
- And, are there any environmental effects?

As we look at ethanol today, every one of these components is critical in determining whether or not to enter into a biomass or ethanol project. In today's economy, ethanol is only worth 95 cents to \$1 per gallon. This illustrates why producing competitively is so important. As more and more plants come on-line, and as existing plants expand, production increases. So, in the long run, it will be the least-cost provider who will survive these periods.

Basically, the need for goods and services is the same thing as supply and demand. The big questions in ethanol are, "Will California continue to use MTBEs? Or will it have to use ethanol? If California has to use ethanol, will a

foreign country produce it, or will it buy it here in the United States from U.S. production?"

Some of the technology changes that should be reviewed, if you're considering starting an ethanol plant today, are:

- How fuel sales will impact the industry and the future of ethanol.
- What the government will do when the incentives run out.
- Whether or nor there will be any environmental threats that could change ethanol.

### Final steps

Once the in-depth steps of the feasibility study and business plan are completed, you need to find an attorney who will prepare a prospectus. This statement outlines the main features of the new business, and is necessary whenever a company issues stock. Its primary objective is to disclose all risks associated with that investment.

After the prospectus has been prepared, you can begin your membership drive. Then you can hold your annual meeting.

You should not seek financing for the project until all these stages are complete. Groups often feel they need to talk to a lender about a financing request before completing the feasibility study. However, a good and true feasibility study will outline the capitalization or equity you need to raise in order to be competitive.

Once the financing is in place, you may need to hire a manager, if you have not done so already. Hiring a manager is one step you can do before the others, as long as you have enough

seed money to pay him or her. Finally, you will construct your plant and begin the operation.

### Keys to success

During the past decade of looking at added-value ventures, CoBank has come up with what we feel are the three most important keys to success—leadership, communication and capacity.

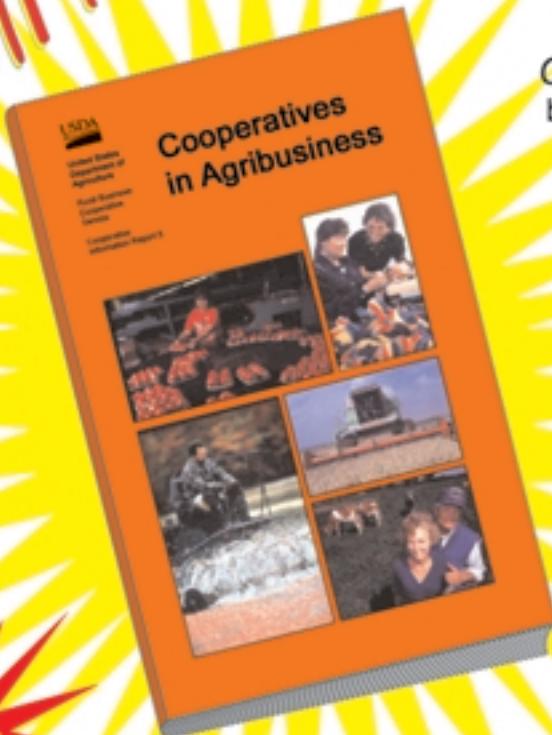
Leadership should be local. It should consist of local producers who are willing to put their reputations and their money at risk. Leadership should not come from engineering firms, marketing companies or economic developers. In addition, an excellent management team that's capable of developing and implementing sound business and marketing plans is critical, as is a well-thought-out risk management plan.

Successful added-value ventures also are well capitalized and able to cushion for unplanned adversities. They have 40 percent to 60 percent equity that's been raised by their investors.

The final essential key to success is communication. This means frequent, open and honest communication with the investors. It means communication that focuses on the value of their stock or their investment, not just the production statistics. And it means communication that is developed from the perspective of an added-value processor, not a commodity or livestock producer.

There's an old saying, "Nothing ventured, nothing gained." Following all of these steps carefully, accurately and in proper order can make all the difference in determining whether your added-value venture achieves success. ■

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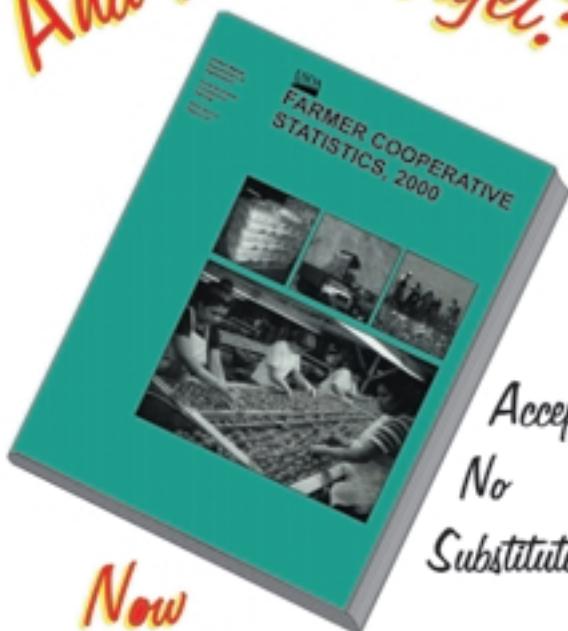


*Cooperatives in Agribusiness* has been given its first major revision in 15 years. Used by schools and other co-op education programs, this publication provides an excellent overview of how modern cooperatives function in today's agricultural economy. Also includes chapters on utility co-ops, credit unions, housing co-ops, etc.

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