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FOR
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COOPERATIVE ACQUISITIONS AND OTHER FORMS OF RESTRUCTURING

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Why is Reorganization Needed?

The number of agricultural marketing, farm supply, and related service cooperatives in the United States declined from 10,064 in 1950-51 to 3,989 in 1983. While the decline in numbers has been persistent, business volume increased from 1974 to 1981 followed by declines in 1981 and 1982. (The trend in business volume was not adjusted for changes in the price level.) The point is, reorganization is not a new phenomenon. It is a persistent condition in a competitive business environment. It has impacted both cooperatives and non-cooperative agribusiness firms.

The question of why reorganization is really too broad to adequately address in one short paper. There are a host of explanations, each one appropriate to a particular situation at a particular point in time. The constantly changing nature of the business environment poses new sets of threats and opportunities. Firms are also unique in terms of their internal strengths and weaknesses.

There are, however, indications that the rather steady rate of reorganization which has persisted since the early 1950's is in fact accelerating during the 1980's. Let's first examine the situation among grain and farm supply cooperatives in the western corn belt. Financial audits received by the Omaha Bank for Cooperatives from 480 cooperative grain and farm supply borrowers for 12 months ending May 20, 1985 show that 35 percent (170 firms) had operating losses in the most recent year of operations while 65 percent (310 firms) reported positive net savings. It isn't this single year of results which is most troublesome, it is the five year trend. In 1980 the 170 cooperatives reported combined net savings of approximately $15 million. The 310 cooperatives had combined net savings of approximately $62 million, (figure 1). Average local savings per firm in 1980 for the two groups was $100 thousand and $200 thousand respectively, (figure 2). By 1984 the average losses per firm of the 170 cooperatives was over $180 thousand, while the 310 firms had average local savings of over $150 thousand. The inquisitive observer then raises the earlier question, why?

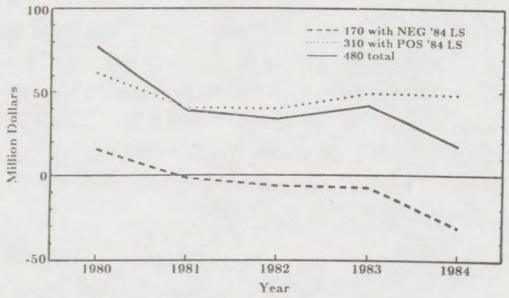

Figure 1. Grain and farm supply cooperative, local savings (total), 5-20-85.

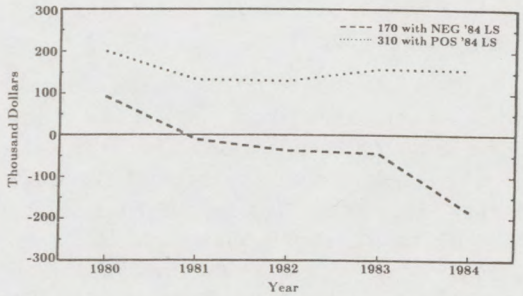

Figure 2. Grain and farm supply cooperatives, local savings (average), 5-20-85.

Average net sales per firm for the 170 negative net savings cooperatives has remained consistently above the average for the 310 positive net savings cooperatives, (figure 3). The difference in 1980 was nearly $3 million. By 1984 it was $1.5 million. Firms with smaller average sales generated net savings while firms with larger average sales lost money.

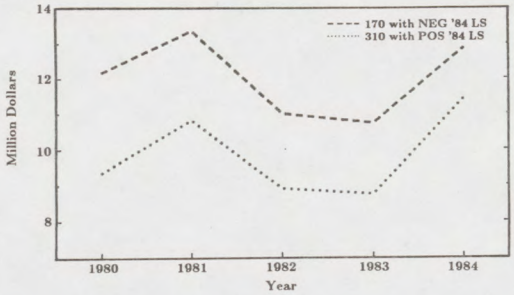

Figure 3. Grain and farm supply cooperatives, net sales (average), 5-20-85.

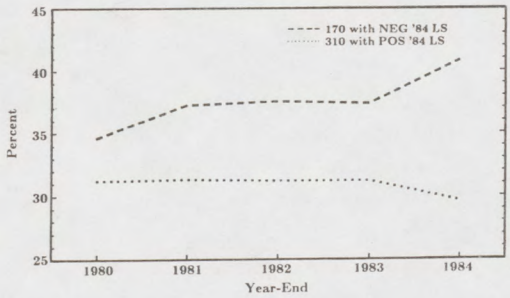

Figure 4. Grain and farm supply cooperatives, personnel expense.

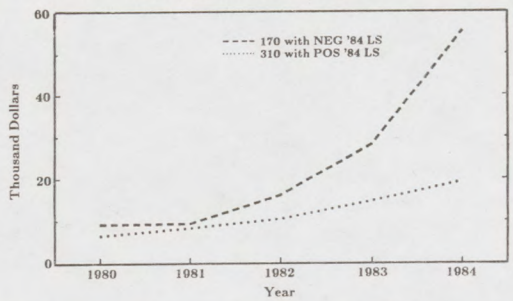

Figure 5. Grain and farm supply cooperatives, bad debt write-offs, 5-20-85.

Personnel expense tends to be the largest single operating expense of local cooperatives. The firms which lost money in 1984 had a consistently high and growing ratio of personnel expense per dollar of gross revenue, (figure 4). The reverse was true for those borrowers which had net savings in 1984.

Bad debt write-off is a visible symptom of the troubled farm economy in the western corn-belt. Average bad debt write-off experience of 170 cooperatives was consistently above the 310 which generated net savings in 1984, and the difference increased dramatically following 1981, (figure 5).

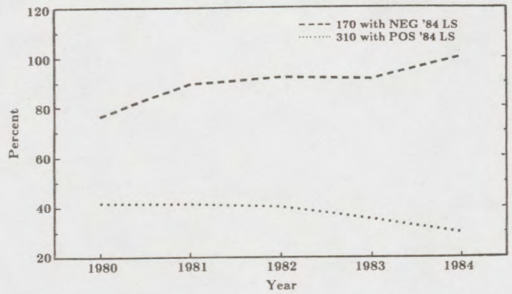

Figure 6. Grain and farm supply cooperatives, term debt, 5-20-85.

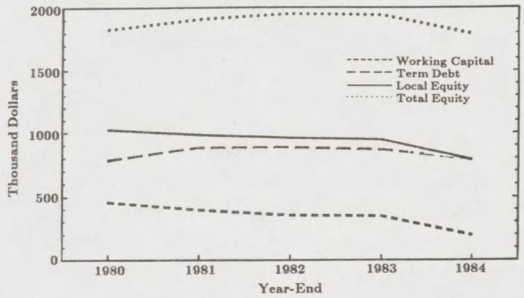

Figure 7. Cooperatives with negative local savings.

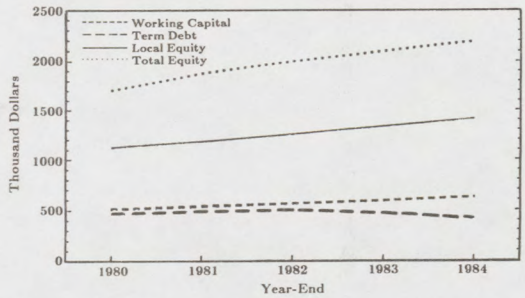

Figure 8. Cooperatives with positive local savings.

The ratio of term debt to equity for the two groups presents a most striking contrast (figure 6). Firms which lost money in 1984 began the decade with a ratio of term debt to local equity of nearly .75:1. This ratio increased to 1:1 by 1984. The ratio for the comparison group was slightly above .40:1 in 1980 and declined to .30:1 by 1984.

Comparisons of average working capital, term debt, local equity, and total equity all favor those cooperatives which have a consistent earnings record (figures 7 and 8). Cooperative finance practices almost guaranteed that result. But, one last illustra-

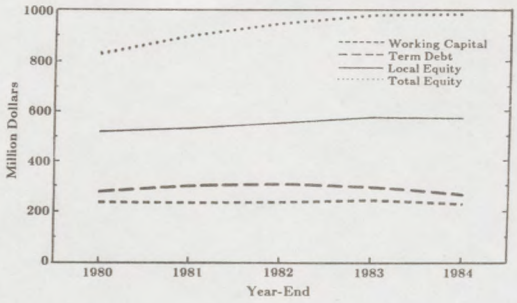

Figure 9. District-wide totals.

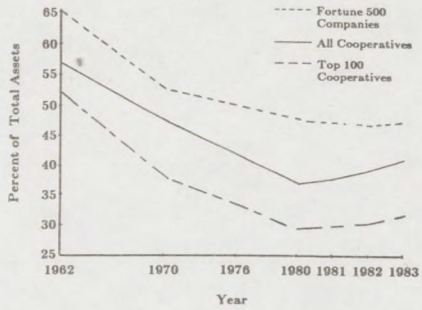

Figure 10. Comparative net worth trends.

tion, which presents the combined totals for all borrowers in the district, shows stability or growth for the combined working capital, term debt, local equity, and total equity for all borrowers, (figure 9).

What conclusions can be drawn from this data? Like production agriculture, the problems of cooperatives in the western cornbelt are not universal. The are instead bimodal in nature. Firms experiencing operating losses are, on the average, larger cooperatives. They have the larger average sales volume, and the larger total equity. Earlier analysis also shows they have a larger average total asset base. Labor efficiency is poor and getting worse. Bad debt write-off shows a similar trend. The highly leveraged term debt to local equity position is dominant.

Reliance on term debt to finance growth in assets prior to 1980 has placed these organizations in a highly vulnerable position. While the data does not reveal the fact, excess capacity is especially prevalent among this group of borrowers. The declining labor efficiency is an indicator of that condition, plus the narrowing spread between average sales volumes of the two groups of firms.

By 1980 these cooperatives were positioned for continued market growth and increasing market shares. In many cases the planned growth in market share was envisioned to be at the expense of smaller neighboring cooperatives. Ironically, it is the latter group, with less debt financing, which continues to generate annual net savings.

These problems are not limited to the local federated grain and farm supply cooperatives in the western corn belt. All of U.S. industry appeared to have lost prior reservations about debt financing during the 1970's. Cooperatives included in a Touche Ross study plus a 1983 study of the 100 largest cooperatives reveals that cooperatives, including the largest regionals, relied heavily upon debt financing during the 1970's (figure 10). That temptation was greater among cooperatives than the average of Fortune 500 companies.

A more detailed analysis of the nominal ownership financing of cooperative assets shows deterioration among all major types of regional cooperatives from 1977 to 1983-84, except for marketing cooperatives, (table 1). On the average assets of the largest 100 cooperatives were 68.4 percent financed by debt in 1983-84. The lack of adequate earnings is obviously a major contributing factor, (table 2 and 3). The earnings performance of regional cooperatives has remained low compared to competing food processing corporations and has shown little improvement or has declined since 1977.

A contention that a comparison of earnings between food processing corporations and cooperatives is inappropriate, seems obvious. There are significant differences between the increasingly diversified food processors and relatively specialized cooperatives. But that is exactly why the comparison is made. It is the diversification of food corporations and their superior earnings record which should be of upmost concern to cooperatives. They are the dominant firms in the market place. Due to their diversification they will be more successful in managing and surviving market risks. They are the competition for cooperatives.

But is reorganization needed? The answer to that question depends upon the

Table 1. Average Earnings Before Income Taxes and Patronage Refunds

	PERCENT OF SALES							
	1977	1978	1979	1980	1981	1982-3	1983-4	NO.
Food Processing Corporations	7.9%	6.8%	6.1%	5.6%	6.1%	4.4%	6.8%	21
Marketing Cooperatives	–		Not Pertinent			–	–	22
Supply Cooperatives	2.8	2.4	1.9	2.4	1.2	(.1)	.5	19
Dairy Cooperatives	.6	.8	1.1	2.0	.5	.4	.8	18
Grain Cooperatives	.5	N/A	N/A	.4	.4	(.1)	.2	4

Table 2. Percent of Net Worth as Percent of Assets Employed

	Percent		
	1977	Percent 1983-4	1977 Percent of 1983-4
Food Processing Corporations	53.3%	44.5%	83.5%
Marketing Cooperatives	29.5	30.0	101.7
Supply Cooperatives	35.1	32.7	93.2
Dairy Cooperatives	36.3	33.8	93.1
Gain Cooperatives	35.5	22.5	63.4
100 Largest Cooperatives	34.0	31.6*	92.9

Table 3. Net Worth of 100 Largest Cooperatives

	1980	1983	1983 Percent of 1980
Equity Certificates & Credits	45.7%	45.2%	98.9%
Preferred Stock	22.8	21.7	95.2
Common Stock	17.2	16.9	98.3
Unallocated Equities	14.3	16.2	113.3
	100.0%	100.0%	

perceived mission of cooperative members, boards of directors, and managers. Several similar, but different missions may exist. The mission may be (1) to provide products and services at competitive prices *today,* (2) to protect the equity of those patrons who have supported the cooperative with their business, (3) to maintain a cooperative presence in the market place as an assurance of present and future market performance and/or (4) to preserve the vitality of the community by continuation of the cooperative as a local business enterprise.

Depending upon the mission the need for reorganization differs. With the prevalence of excess industry capacity there may be no need for the cooperative as an additional competitor in *today's* market. A cooperative which is experiencing persistent and growing losses will not be successful in offering competitive prices and services. In the past, industry reorganization has eliminated these firms.

If the mission is to protect members' equity the conclusions will be similar for cooperatives experiencing continuing losses. Members' equity may be preserved by liquidating now rather than allowing further erosion through added losses. As more facilities are sold the salvage value of cooperative assets is falling. Evidence of that fact is increasingly apparent in the western cornbelt.

Cooperative presence as a solution to desirable market performance may be a third alternative. This may have the strongest philosophical appeal. And it may ultimately prove to be the most compelling argument. The increasing integration of the food processing industry by relatively few dominant conglomerate enterprises is, at the very least, impressive. That trend appears to be accelerating in the midst of an agricultural depression. Acquisition of subsidiary enterprises at fire sale prices is easily accomplished by firms which began the 1980's with a solid balance sheet. While the need for cooperatives to respond in a countervailing fashion is real, the ability of cooperatives to do so has been substantially constrained by nominal net savings/losses and highly leveraged balance sheets.

The preservation of vitality in local communities may be the most compelling motivation for local decision makers. The lack of rationality in this mission is frequently lost through an internalized focus in planning and management decision making.

To achieve some part of one or more of the above missions will require reorganization. It will also require sacrifices of other missions. Conflicts between these missions are apparent.

Impact on the Cooperative Community

Where are cooperatives most vulnerable? The greatest vulnerability appears to rest with the highly leveraged firms. This includes as many as 35 percent of the locally owned cooperatives in the western cornbelt, and some of the largest regional cooperatives in the nation. In most cases these are the cooperatives which were most aggressive during the growth markets of the 1970's. They have the superior fixed assets which were heavily financed with debt. They were also successful in capturing major market shares among cooperatives. They have in their employment some of the most progressive managers who have excellent leadership abilities. If liquidated, their best assets may saturate the market for marketing and farm supply facilities even at depressed prices. Again, present evidence supports that conclusion at both the local and regional level.

Analysis by Ginder clearly illustrates that facilities which are sold at 55 percent of book value and financed 50 percent with debt can eliminate identical competitors which continue to operate at original purchased cost and are also financed with 50 percent debt. Cooperative facilities are typically being sold well below 55 percent of book value in 1985.

Given these conditions, failure to reorganize has severe implications for the cooperative community. The size of the larger unprofitable local cooperatives makes it difficult or impossible for a single smaller profitable local cooperative to initiate an acquisition. Social impediments generally preclude two or more small locals from joining forces to acquire the larger company.

Market share is a major contention. It is even a greater threat if a non-locally owned organization acquires the facilities of the larger failed cooperative.

The implications of these developments are clearly recognized by regional suppliers. As a result, regionals are quietly bidding for the better facilities of locals facing foreclosure, even in a federated system. This is truly a catch 22 proposition. With highly leveraged balance sheets, regionals should have little interest on acquiring additional fixed assets, even at bargain prices. But with excess farm supply manufacturing capacity, the regional cannot afford the loss of major market shares controlled by the larger locals.

Again a conclusion of reorganization is inescapable. The required reorganization must be broader in scope than either local or regional cooperatives have experienced. Reorganization involving only two, or even three local cooperatives is unlikely to prove beneficial. In many situations the reorganization plan must be sufficiently broad in scope to support and salvage the struggling dominant cooperative in the area. In areas of high cooperative density the reorganization may involve more than one dominant cooperative. (It is appropriate to note that not all of the largest cooperatives are losing money, local or regional.) It will also require resolution of excess capacity, a good part of which is likely to reside in the profitable smaller cooperative. This means re-routing product flows to the more efficient newer facilities of the larger cooperative.

Alternative Approaches

And who will provide the leadership for reorganization? A larger cooperative which is facing liquidation, a smaller company which is profitable, the banker who provided the financing to both, or the regional grain marketing or farm supply cooperative? The issue really isn't alternatives. The alternatives are generally known. To the extent that some are yet untried in certain segments of the cooperative industry is not an issue. Explanation of the alternative are available and are readily understandable. Dr. Randall Torgerson addressed this topic earlier in this program and on previous occasions.

The issue is implementation. In the federated cooperative system the problems of implementation reside in local communities with local decision makers. The pipeline for information feedback to decision makers is too short. The fact that cooperatives unwittingly find themselves targeting the medium and small farm operator who is middle aged to older also supports that conclusion.

Participation by all parties is needed for implementation of reorganization, including the banker and regional. And equal participation by all parties is also needed, if not required. Loss of some creditability by both bankers and some regionals is a prevailing reality. As a result their leadership roles have been compromised.

Success in implementation will require an intensity of commitment to a thorough planning process which has generally yet to be achieved. It is possible for cooperative, and it can lead to success. The creation and successful operation of Agri Processors with headquarters in Omaha, Nebraska is one example. Born though adversity, with more than two parents, Agri Processors has dealt with the challenge of excess capacity including an array of facilities from the most efficient to obsolete.

Many local and regional cooperatives are now familiar with the terminology of planning. But they have only begun. They are far from being committed disciples. Corporate experiences suggest that at least a year is required to develop a commitment to a mission statement as the first step. Most local boards of directors attend a two day board retreat once each year for the purpose of planning. In my experience most of that two days is focused on internal operations. That is not the critical issue.

The greatest threat to the cooperative system is time. Moving quickly enough for reorganization to take advantage of remaining opportunities is a very real concern. The record 1985 harvest throughout the cornbelt buys some additional time for cooperatives. If the reaction is a sigh of relief by managers

and board members, the future is indeed grim for agricultural cooperatives.

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